No. 07-164

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In The
Supreme Court of the United States

KINDER MORGAN CO_2 COMPANY, L.P.,

Petitioner,

v.

J. CASPER HEIMANN, PECOS SLOPE ROYALTY TRUST and RIO PETRO LTD., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico similarly situated,

Respondents.

On Petition For Writ Of Certiorari To The Court Of Appeals Of The State Of New Mexico

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

I. Whether Petitioner has presented compelling reasons to grant the Petition, where the New Mexico Court of Appeals Opinion is consistent with and faithfully applies decisions of this Court recognizing that arbitration is a matter of contract, and that parties are not obligated to arbitrate disputes they have agreed are not subject to arbitration, in light of the operative provision of the Feerer Settlement Agreement ("FSA") that provides "This provision concerning arbitration applies only to the claims identified in this paragraph 16 and shall, in no event, apply to any future claims for breach of this Agreement"?

II. Whether Petitioner has presented compelling reasons to grant the Petition, where the Petition is based on (a) a misconstruction of the approved royalty payment methodology and the arbitration provision set forth in the FSA, (b) a mischaracterization of the class action complaint, and (c) a misreading of the New Mexico Court of Appeals decision?

III. Whether Petitioner has presented compelling reasons to grant the Petition, where the Petition is based on the erroneous contention that the New Mexico Court of Appeals decision regarding the contract claims in the class action complaint was based solely on the narrow scope of the arbitration provision, and where there is no split in the circuits that requires review by this Court, because the universal rule is that the federal presumption in favor of arbitration cannot override an express agreement that a particular dispute is not subject to arbitration?

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INTRODUCTION

Petitioner Kinder Morgan CO_2 Company, L.P. ("Kinder Morgan") has presented no "compelling reason" for its Petition for a Writ of Certiorari ("Petition") to be granted. See Sup. Ct. R. 10. Three New Mexico courts have considered the same arguments advanced in the Petition and, after thorough briefing, a review of the record, and oral argument, have reached the same conclusion this Court will ultimately reach, i.e., that Royalty Owners' ("Royalty Owners") are not obligated to arbitrate breach of contract claims[1] where the operative agreement, the Feerer Settlement Agreement ("FSA"), expressly provides that the narrow arbitration provision "shall, in no event, apply to any future claims for breach of this Agreement." This result is mandated by the rule announced by this Court in *AT & T Technologies, Inc. v. Communications Workers of America,* 475 U.S. 643, 648 (1986), which held that "arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit."

Kinder Morgan attempts to manufacture an issue of "exceptional importance under the Federal Arbitration Act" ("FAA"). It claims it has been deprived of its

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[1] The New Mexico Court of Appeals correctly recognized that the claims for royalty underpayment in the class action complaint based upon breach of contract, breach of the duty of good faith and fair dealing, and breach of the implied covenant to market, are contract-based.

"arbitration rights" under the FAA. There is no constitutional or statutory right to arbitration. Arbitration is a matter of contract between the parties. The parties here agreed that claims for breach of the FSA would not be subject to arbitration.

The Royalty Owners' claim for royalty underpayment is based on the fact that Kinder Morgan did not follow the approved methodology set forth in the FSA in calculating and paying royalties for carbon dioxide ("CO_2") produced from the Bravo Dome Unit in northeastern New Mexico. Respondents' Appendix ("Resp. App."), 5-6. The parties in the FSA approved certain contracts called Qualified Contracts for future royalty payments. The agreement provides that, absent some other agreement between the parties, all royalty payors, including Kinder Morgan, were required to pay royalty based upon approved contract prices under Section 14(c), using "the volume weighted average of their respective prices for Unit CO_2 as provided in 14(b), utilizing a net-back methodology . . . utilizing the prices or values established in their respective Qualified Contracts . . . that apply to the volumes of Unit CO_2 sold or delivered under such Contracts." Kinder Morgan did not and does not utilize a volume weighted average price under Qualified Contract prices to calculate royalties as specified by the FSA. The Royalty Owners have still not been able to determine whether and to what extent Kinder Morgan used Non-Qualified Contract prices, "other benchmarks", or some other values in calculating

royalty payments. The appellate proceedings have precluded merits discovery since 2005.

Kinder Morgan bases its case for arbitration on a narrow arbitration clause that calls for arbitration of disputes regarding prices or values under Non-Qualified (unapproved) Contracts. Pet. App. 102. There is no allegation in the complaint regarding Non-Qualified Contracts. The fact is that Royalty Owners did not know precisely how Kinder Morgan calculated royalties when the complaint was filed. They still do not know. The royalty remittance statements Kinder Morgan provides class members do not disclose the basis for the prices used by Kinder Morgan to calculate royalties. When the complaint was filed, the Royalty Owners did know that many of the Qualified Contracts tied the price of Unit CO_2 to the price of oil. During the period 2000-2004, as oil prices rose significantly, the price of Unit CO_2 reported by Kinder Morgan upon which royalties were paid fell.

Because it has no right to arbitration under the unambiguous language of Section 16 of the FSA, Kinder Morgan accuses the Royalty Owners of attempting to avoid the arbitration provision through "artful pleading." Kinder Morgan offers no evidence to support this accusation because there is no such evidence in the record.

Finally, Kinder Morgan attempts to manufacture out of whole cloth an alleged split in the federal circuits on the standard courts should apply to analyze narrow arbitration provisions. The implication is

that this Court needs to resolve the issue and settle the alleged sharp division between the circuits. Petition, pp. 14-18. Nothing could be further from the truth. While different courts may articulate the standard to determine arbitrability differently, they all apply the same standard substantively. There is no split. Even if there were, the alleged split in the circuits regarding the standard of review for narrow arbitration clauses is a false issue because the New Mexico Court of Appeals did not apply the more restrictive test or require proof that the claim is "on its face within the purview" of the arbitration clause in deciding the case below. The Court of Appeals ruling is right under any test of arbitrability.

Kinder Morgan focuses solely on the narrow arbitration provision of the FSA. The court below recognized that the FSA contains both a narrow arbitration clause *and* an express exclusion from arbitration for claims for breach of the FSA. The court below correctly held that the narrow arbitration provision could not trump the unambiguous exclusion clause, and that the federal policy favoring arbitration did not render that exclusion void or obligate the Royalty Owners to arbitrate disputes they did not agree to arbitrate. The FAA allows parties to exclude claims from arbitration even where they provide for arbitration as to a narrow class of disputes.

Kinder Morgan also contends that there is a conflict between the New Mexico Court of Appeals decision and the law of the Fourth Circuit. A review of the cases cited by Kinder Morgan demonstrates no

conflict. Even if there were a dispute between those jurisdictions, it would not present a compelling reason for review by this Court because New Mexico courts are not bound by Fourth Circuit precedent.

STATEMENT OF THE CASE

Nature of the Case.

The Royalty Owners filed this lawsuit individually and on behalf of a class of similarly situated private royalty and overriding Royalty Owners against Kinder Morgan to recover damages for underpayment of royalties based on production of carbon dioxide ("CO_2") from the Bravo Dome Unit ("Unit") in northeastern New Mexico.[2] The named plaintiffs Pecos Slope and Rio Petro were members of the class certified in *Feerer, et al. v. Amoco Production Company, et al.*, USDC Cause No. Civ. 95-0012

[2] The Royalty Owners initially filed a claim in arbitration against Kinder Morgan and an identical arbitration demand against OXY USA Inc., ("Oxy"), the Unit operator and largest Unit working interest owner. Because the Royalty Owners did not know how royalties were calculated, the arbitration filing was based on the assumption that corporate defendants would prefer arbitration to litigation. Oxy responded to the arbitration demand by filing a declaratory judgment action seeking a determination that the claims for royalty underpayment were based on breach of the FSA and were not subject to arbitration. The Royalty Owners then withdrew the arbitration demands and filed class action lawsuits. The claims against Oxy were resolved on the verge of a jury trial by settlement in October 2005.

(D.N.M. 1998) (*"Feerer"*), a prior federal class action lawsuit for royalty underpayment. Kinder Morgan is a successor to Shell CO_2 Company Ltd., a *Feerer* defendant and party to the FSA. Kinder Morgan has paid royalties to the Royalty Owners since January 2000. R.P. 199.

The Class Action Complaint alleges that Kinder Morgan breached the FSA and related implied covenants and underpaid royalties to the class, that Kinder Morgan failed to pay royalties in accordance with the FSA, that Kinder Morgan has "set 'prices' that are not formed by true market forces," and are grossly less than the value relative to the oil produced by Kinder Morgan using the CO_2, and that Kinder Morgan "has breached its contractual obligations and acted in bad faith by fabricating improper and dishonest 'prices' for Unit CO_2." Pet. App. 39-41. The complaint also asserts claims for constructive fraud and violation of the New Mexico Unfair Practices Act. Pet. App. 37-38. It seeks equitable relief in the form of accounting and injunction. Pet. App. 42-43. There is no allegation in the Complaint that references prices or values under Non-Qualified Contracts or Non-Qualified Other Transportation Charges. Pet. App. 27-44. The complaint does not even mention Non-Qualified Contracts.[3] Most of the CO_2 upon

[3] The Court of Appeals decision does reference that plaintiffs "contend that Kinder Morgan modified the parties agreed on methodology for calculating royalties, by using non-qualified contracts in the royalty calculations." Pet. App. 4. This is not the

(Continued on following page)

which Kinder Morgan is obligated to pay royalty is not bought or sold but is delivered in-kind for Kinder Morgan's own use.

Kinder Morgan filed a Motion to Compel Arbitration two months after the complaint was filed, and disclosed for the first time to the Royalty Owners some information on how it valued the Unit CO_2 for royalty purposes. Resp. App. 2-3. According to Kinder Morgan's expert, the regular monthly payment statements Kinder Morgan sends to the Royalty Owners with their checks do not reveal "when qualified contract number 3 was discontinued and was no longer being used," or whether "only qualified contracts were being used to arrive at the price." Resp. App. 54. Kinder Morgan submitted an expert report from an economist who analyzed Kinder Morgan's royalty payment methodology. The Royalty Owners then filed a Supplemental Response to the Motion with an affidavit from their expert challenging Kinder Morgan's royalty payment methodology and outlining Kinder Morgan's breaches of the FSA. Resp. App. 2-55.

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basis for the Royalty Owners' claims for breach of contract. This statement is contrary to other statements in the Court of Appeals decision that recognizes that "Plaintiffs may not dispute the prices under nonqualified contracts at all."

Summary of Material Facts.

The Bravo Dome Unit and CO_2 Production.

The Unit is situated in Harding, Union and Quay Counties, New Mexico. It is one of the largest carbon dioxide producing units in the United States and contains what is believed to be one of the largest accumulations of recoverable CO_2 reserves. Oxy is the unit operator with a working interest of about 75%. Kinder Morgan's working interest in the Unit is approximately 11%.

Once produced, Unit CO_2 is gathered, dehydrated and compressed at the Unit. The compressed CO_2 is then transported via pipeline to enhanced oil recovery ("EOR") projects in the Permian Basin in southeastern New Mexico and west Texas. Enhanced Oil Recovery refers to a method used to obtain incremental oil production from crude oil reservoirs over that which can be economically recovered in conventional primary and secondary recovery methods.

The CO_2 industry is vertically integrated. Kinder Morgan is one of the companies who have CO_2 supply and also operate EOR projects. The same major participant oil companies, including Kinder Morgan, typically own interests in CO_2 producing units, in the pipelines that transport CO_2 to EOR projects, and the EOR projects themselves. A large percentage of the CO_2 produced by Kinder Morgan at the Unit is injected in its own EOR projects in the Permian Basin; that is, it is used "in-kind" or exchanged with other

EOR operators, not sold or purchased. There is no active market for the CO_2.

The Relevant Provisions of the FSA.

Kinder Morgan's predecessor (Shell) and the other defendants paid over $47 million to settle the claims of the Royalty Owners in *Feerer*. The FSA set out the parties' agreement on the proper method for calculating future royalty payments Kinder Morgan would make to the Royalty Owners.

Kinder Morgan is obligated to pay royalty on "Unit CO_2", a defined term under the FSA that means carbon dioxide produced from the Unit, compressed and delivered into a pipeline. The approved royalty payment methodology is set out in Section 14 of the FSA. It requires Kinder Morgan to "utilize the royalty settlement methodology and the identified benchmarks set forth in subparagraphs (a), (b) and (c) below for the purpose of calculating and paying royalty . . . ". Pet. App. 98.

Section 14(a) requires Kinder Morgan to pay royalty on all of its allocated volumes of CO_2 pursuant to the Unit Agreement or other applicable contracts. *Id.* Section 14(b) requires Kinder Morgan to pay royalty "on the basis of the volume weighted average of the prices for [its] respective sales or other dispositions of Unit CO_2 that [it] separately dispose[s] of or take[s] in kind." Pet. App. 98-99. In other words, Kinder Morgan cannot use prices from sales or dispositions

established by other Unit royalty payors in calculating royalties.

Section 14(c) is the critical provision for purposes of the claims in this case. It provides that Kinder Morgan will pay its Royalty Owners for Unit CO_2 volumes specified in 14(a), "on the basis of the volume weighted average of their respective prices for Unit CO_2 as provided in 14(b), utilizing a net-back methodology . . . **utilizing the prices or values established in their respective Qualified Contracts** . . . that apply to the volumes of Unit CO_2 sold or delivered under such Contracts." (Emphasis added). Pet. App. 99-100. The only approved methodology in this section involves volume weighted average prices under Qualified Contracts, which are listed in Exhibit D-1 to the FSA. *Id.* No other royalty payment methodology is approved by the FSA. The FSA does not approve the use of prices for sales or dispositions established by other benchmarks or Non-Qualified Contracts. *Id.* The volume weighted average price derived from Qualified Contracts is approved as a method for valuing **all** (including in-kind volumes) of Kinder Morgan's Unit CO_2 and paying royalties to the Royalty Owners. *Id.*

The parties to the FSA recognized that there may come a time when there were no Qualified Contracts, or that other benchmarks might be used to calculate future royalties. They agreed that "Nothing herein is intended to suggest that other benchmarks that may be utilized in the future to determine royalty settlement values that are not characterized as qualified or

approved . . . are improper." Pet. App. 100. Instead, the parties agreed "to omit any agreement concerning whether or not such future benchmarks, and resulting future royalty payments, are or are not proper." *Id.*

The FSA did not pre-approve Kinder Morgan's use of other benchmarks or Non-Qualified Contracts to determine royalty settlement values. The FSA provides that if other benchmarks and/or Non-Qualified Contracts are used, they must be "proper." *Id.*

In addition to the use of agreed Qualified Contracts, the parties to the FSA used two separate and distinct terms to identify other possible sources of prices or values: benchmarks and Non-Qualified Contracts. "Benchmarks" is not a defined term in the FSA. This is the term used by the parties in Section 14(c) to identify other sources of prices or values. Pet. App. 100. "Non-Qualified Contracts" are defined in Section 14(g) as "all contracts for the sale, exchange or other disposition of CO_2" entered into by Kinder Morgan after the date of the FSA or which are not listed on Exhibit D-3. *Id.* Section 14(j) provides that with respect to Non-Qualified Contracts "nothing herein shall be construed to affect or supplant any legal or contractual duties that may be owed" to the Royalty Owners by Kinder Morgan in entering contracts for the sale or other disposition of Unit CO_2. Pet. App. 101. The Royalty Owners retained all rights to claim that Non-Qualified Contracts or Non-Qualified Other Transportation Charges relied upon in establishing

royalty settlement values are "improper for any reason." Pet. App. 102.

Section 16 contains the arbitration provision that is the focus of this appeal. The section begins with a narrow arbitration provision that identifies the only claims subject to arbitration are claims regarding the price or value under Non-Qualified Contracts and Non-Qualified Other Transportation Charges. Pet. App. 102-103. The section does not reference claims related to the use of other benchmarks, or claims based on the failure to calculate the royalty pursuant to 14(a)-(c). *Id.* Arbitration is triggered upon notice by one party to the other of a demand for arbitration which sets forth the matter or matters to be submitted and the name of an arbitrator. *Id.*

More importantly, Section 16 concludes with the general exclusion from arbitration for claims for breach of the FSA. The exclusion utilizes the mandatory "shall," and emphasizes the exclusion by qualifying it with the phrase "in no event." In so doing, the parties confirmed their agreement that no claim for breach of the FSA would be subject to arbitration, and that the general exclusion would control in the event of a conflict with the narrow arbitration provision.

Section 55 of the FSA is not included in Kinder Morgan's Appendix. It provides that "No modification or waiver of, addition to, or deletion from the terms of this Agreement shall be effective unless and until reduced to writing and signed by all of the Parties." Any modification that reduces or impairs any benefit

to the Royalty Owners "shall require approval by the Court."

Misstatements in the Petition.

Throughout the proceedings below and here Kinder Morgan relies on misstatements of fact to support its arbitration demand. First, Kinder Morgan contends that it pays royalties to the Royalty Owners on the proper value of the carbon dioxide at the unit. Petition, p. 6. Whether Kinder Morgan has properly paid royalties on the value of carbon dioxide at the Unit has not been adjudicated. The Court of Appeals did not address the merits of the claim. Pet. App. 8.

Kinder Morgan rewrites the approved royalty payment methodology to authorize the use of **all sales prices** obtained in all sales and other dispositions of carbon dioxide to pay royalties. Petition, p. 6. In fact, Section 14(c) of the FSA does not authorize the use of "all sales prices" in calculating royalties. It expressly approves only the use of "prices or values established in their respective Qualified Contracts." Pet. App. 99. The only approved methodology in the FSA for valuing all Kinder Morgan's production is the use of a volume weighted average price based upon prices or values established in Qualified Contracts, Pet. App. 98-102. There has been no determination in this case that Kinder Morgan is authorized to utilize unapproved sales prices to calculate royalties, and no determination as to whether the prices or values utilized by Kinder Morgan are proper.

Next, Kinder Morgan argues that Section 14(c) gives it the right to use 'other benchmarks' in the weighted average net-back price calculation. Petition, p. 11. Again, this contention is refuted by reading the FSA. Nowhere in Section 14(c) is there any express authorization for Kinder Morgan to use anything other than prices or values established in Qualified Contracts, i.e., approved prices. Pet. App. 98-102. The FSA reserves judgment as to whether "other benchmarks that may be utilized" are proper or improper. Pet. App. 102. The agreement requires that any modification of the terms be in writing and signed by the parties, and that the Court approve any modification that reduces or impairs any benefit of the Royalty Owners.

The fact that the parties "omit any agreement concerning" other benchmarks that might be used to calculate royalties at some time after the FSA was executed does not constitute an agreement that Kinder Morgan has the right to unilaterally modify the royalty payment methodology in Section 14(c). Kinder Morgan would misread an expression of non-agreement as constituting an agreement.

Kinder Morgan must pay lip service to the Section 16 exclusion for breach of contracts claims, so it argues that the exclusionary clause is limited to certain prohibitions contained in other provisions of the FSA, such as Sections 9.2, 10, 11.2, 11.4 and 12. Petition, p. 8. This theory is not supported by the language of Section 16. To the contrary, the exclusion for claims for "breach of this Agreement" is broad and not subject to any restriction. Pet. App. 103. It was

inserted in the FSA to prevent the conduct engaged in by Kinder Morgan, i.e., the unilateral use of unapproved pricing methods without disclosure to the other parties to a multi-lateral agreement.

Kinder Morgan would have this Court believe that there is no definitive CO_2 valuation method set forth in the FSA. Kinder Morgan's position is that once the federal court approved the FSA on April 1, 1998, it could begin valuing the Unit CO_2 using contracts unknown to and not approved by the Royalty Owners. The Royalty Owners could challenge Kinder Morgan's unilateral departure from the approved methodology only if they discovered Kinder Morgan's internal accounting practices so they then could make an arbitration "demand [that] shall set forth the matter or matters to be submitted . . . ". Pet. App. 103.

THE COURT OF APPEALS OPINION

The opinion at issue here is the opinion of the New Mexico Court of Appeals dated August 8, 2006. That opinion recognized the presumption in favor of arbitration, acknowledged and applied the test that "an order to arbitrate the particular grievance should not be denied unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute," and recognized that this rule is "particularly applicable" where a broad arbitration

clause is involved. Pet. App. 8. The Court concluded that in light of the unambiguous exclusion clause of Section 16, the parties to the FSA excluded from arbitration claims for breach of the FSA. Pet. App. 10-14.

Kinder Morgan supports its Petition by misstating the holding of the Court of Appeals in two respects. First, Kinder Morgan contends that the Court of Appeals ignored the presumption favoring arbitration, and held the presumption does not apply in a case involving a narrow arbitration agreement. That is not true. The Court of Appeals noted that both the FAA and the New Mexico Uniform Arbitration Act express a strong presumption in favor of arbitrability. Pet. App. 8. In addressing Kinder Morgan's reliance on the Section 16 arbitration provision, the Court of Appeals noted that "Because the clause is narrow, our usual presumption in favor of arbitration will not resolve the issue." Pet. App. 15. The Court ultimately concluded that "the presumption does not operate to create a right to arbitrate claims the parties have not agreed to arbitrate," citing this Court's *AT & T* decision, 475 U.S. at 648-49 (1986). The Court expressly recognized the rule that an order to arbitrate a particular grievance should not be denied unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute, and noted that this provision is "particularly applicable" when the arbitration clause at issue is broad. *Id.* Pet. App. 8-9.

Next, Kinder Morgan contends that the Court of Appeals abandoned its duty to determine arbitrability

based upon a "lack of clarity" in the complaint. Again, this contention is at odds with the opinion itself. In analyzing the arbitrability issue, the New Mexico Court of Appeals distinguished the claims in the complaint. As to the contract-based claims for breach of contract, breach of the covenant of good faith and fair dealing, and breach of the implied duty to market, the Court of Appeals found no lack of clarity: "Claims for breach of contract are necessarily claims for breach of the settlement agreement, because that agreement is the only contract between the parties." Pet. App. 10. The Court examined the facts alleged to determine whether this claim is actually for breach of the settlement agreement, and concluded "that it is." Pet. App. 12. The Court of Appeals further found that the claim of breach of good faith and fair dealing sounds in contract, and consequently found that the claim "is not subject to arbitration." Pet. App. 13. Finally, with respect to the claim for breach of an implied covenant to market, the Court again found that "plaintiffs thus allege breach of the settlement agreement in their fourth claim." *Id.*

The references in the Court of Appeals opinion to a "lack of clarity" in the complaint involved only the non-contract based claims for violation of the New Mexico Uniform Practices Act, constructive fraud, unjust enrichment, and the request for an accounting. The allegations supporting those claims were necessarily general, not out of an attempt at "artful pleading," but because the Royalty Owners did not know how Kinder Morgan calculated royalties at the time

the complaint was filed. The Court of Appeals dealt with that issue properly. The Court denied Kinder Morgan's Motion to Compel Arbitration, but nevertheless held that if, as the case proceeds, it becomes clear that "prices of non-qualified contracts or transportation charges are at issue with respect to the Uniform Practices Act, fraud, and/or unjust enrichment claims," the district court should order arbitration of those claims. Pet. App. 18-19. That ruling has nothing to do with the claims for breach of contract, breach of the duty of good faith and fair dealing, or breach of the implied duty to market.

In any event, that portion of the Court of Appeals decision is a non-issue. Kinder Morgan has agreed to a Class Certification Order which approves class certification only for the claims for breach of contract, breach of the duty of good faith and fair dealing and breach of the implied duty to market. Resp. App. 57-63. Those are the only claims which Royalty Owners will prosecute in this class action lawsuit.

REASONS FOR DENYING THE PETITION

I. The Decision Below Gave Proper Legal Effect To The Parties' Agreement That Claims For Breach Of Contract Are Not Subject To Arbitration.

A. Kinder Morgan Agreed That Claims For Breach Of The FSA Are Not Arbitrable.

The Royalty Owners have a constitutional right to have their claims for damages determined by a jury unless they have contractually agreed to arbitrate the claims. N.M. Const. Art. 2, §12. The issue for the Court to decide is whether the parties agreed to arbitrate the matters under dispute in the Class Action Complaint. *Volt Information Sciences, Inc. v. Board of Trustees,* 489 U.S. 468, 474-5 (1989). The FAA does not require parties to arbitrate when they have not agreed to do so. An agreement to exclude from arbitration "any future claims for breach of this Agreement" is a clear expression of intent to exclude those claims from arbitration. The Court of Appeals correctly applied the exclusion.

The initial inquiry requires the Court to determine whether the parties agreed to arbitrate the dispute. The FAA allows parties to exclude certain claims from the scope of their arbitration agreement, and requires that the court give effect to provisions excluding disputes from arbitration. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.,* 473 U.S. 614, 626 (1985). An arbitration provision cannot

be extended beyond the parties' intent. *Volt, supra,* 489 U.S. at 478; *AT & T Technologies, supra,* 475 U.S. at 648-49 (party cannot be required to submit to arbitration any dispute he has not agreed to submit); *Prima Paint Corp. v. Flood & Conklin Mfg. Co.,* 388 U.S. 395, 404 n.12 (1967) (purpose of FAA "was to make arbitration agreements as enforceable as other contracts, *but not more so*").

The analysis of an arbitration provision is the same as that for construction of any contract. *Mitsubishi Motors, supra* at 626. A court will not rewrite a contract for the parties but should apply the plain meaning of the contract language. A court should adopt a construction that gives effect to all contract provisions, *Smith v. Tinley,* 100 N.M. 663, 664, 674 P.2d 1123, 1124 (1984), and should not adopt a construction that renders some contract provisions superfluous. *Bank of New Mexico v. Sholer,* 102 N.M. 78, 79, 691 P.2d 465, 466 (1984). The Court of Appeals correctly held that whether a claim falls within the scope of an arbitration agreement turns on the factual allegations in the complaint. *Gregory v. Electro-Mechanical Corp.*, 83 F.3d 382, 384 (11th Cir. 1996); *P&P Industries, Inc. v. Sutter Corp.*, 179 F.3d 861, 871 (10th Cir. 1999).

The Royalty Owners assert as their primary claim for relief a claim for breach of the FSA based on Kinder Morgan's failure to properly pay royalties as required by the formula provided in Section 14. Section 16 of the FSA expressly excludes claims for

breach of contract from the scope of the narrow arbitration provision. Pet. App. 103. The Court of Appeals correctly applied the broad exclusion, which is fatal to Kinder Morgan's appeal with respect to the Royalty Owners' claims for breach of the FSA, breach of the covenant of good faith and fair dealing, and breach of the covenant to market.

Kinder Morgan contends that the Court of Appeals simply accepted the Royalty Owners' characterization of their claims as contract-based in resolving the arbitration issue. Petition, pp. 23-26. There is no dispute in this case that the Royalty Owners have asserted claims for breach of contract, breach of the duty of good faith and fair dealing, and breach of the implied duty to market. The Court of Appeals independently analyzed these claims and correctly determined that they were contract claims, and therefore fell within the exclusion. Pet. App. 12-13.

B. A Presumption In Favor Of Arbitration Does Not Trump The Express Exclusion Of Section 16.

Kinder Morgan contends that the Court of Appeals held that "the presumption favoring arbitration does not apply in a case involving a narrow arbitration agreement or when there is an exclusionary clause in an arbitration agreement." That is simply not true. The Court of Appeals noted that both the Federal Arbitration Act and the New Mexico Uniform Arbitration Act "express a strong presumption in

favor of arbitrability." Pet. App. 8. The Court of Appeals recognized the presumption but correctly concluded that "The presumption does not operate to create a right to arbitrate claims the parties have not agreed to arbitrate," citing this Court's *AT & T* decision. Pet. App. 8-9.

Kinder Morgan's repeated mantra of the presumption in favor of arbitration does not change the language of Section 16 of the FSA. It does not change the fact that the parties excluded from arbitration claims for breach of the FSA using the mandatory "shall" term and providing further emphasis on the exclusion by providing that "in no event" would future claims for breach be subject to the FSA. The federal presumption in favor of arbitration does not change the fact that the parties agreed upon a narrow arbitration clause that applies only to claims regarding prices or values under Non-Qualified Contracts. It does not change the fact that the Royalty Owners did not reference Non-Qualified Contracts in their complaint. The policy favoring arbitration cannot extend the application of an arbitration clause beyond its intended scope. *McDonnell Douglas Fin. Corp. v. Pennsylvania Power & Light Co.*, 858 F.2d 825, 831 (2d Cir. 1988).

C. Kinder Morgan's Misconstruction Of The FSA Was Considered And Rejected Below.

Kinder Morgan raises several complaints designed to give the false impression that the Court of Appeals did not properly consider its position below. There is no basis for these complaints.

First, Kinder Morgan contends that the Court of Appeals did not consider its narrow interpretation of the FSA provision excluding from arbitration claims for breach of the FSA. Petition, p. 25. Again, this statement is simply not supported by a reading of the opinion below. The Court of Appeals considered but correctly recognized that Kinder Morgan's interpretation made no sense: "Its interpretation of the arbitration agreement would leave essentially no viable claims that would not be subject to arbitration, despite the fact that the arbitration clause is narrow and explicitly excludes claims for breach of the settlement agreement." Pet. App. 6.

The Court of Appeals was correct. Under Kinder Morgan's theory, breach of affirmative provisions such as the key terms of Section 14(a)-(c) would not constitute a breach of the agreement. There is no support in the record for this argument, which is contrary to the express language of the exclusion for "any future claims for breach of this Agreement." The parties to the FSA could have excluded from arbitration only breaches of Sections 9-11 of the FSA, but did not do so.

Next, Kinder Morgan argues that Court of Appeals blindly adopted the Royalty Owners' construction of Section 16 so as to negate the arbitration provision such that claims regarding price or value under Non-Qualified Contracts would be excluded from arbitration. Petition, pp. 18-20. The argument hinges on Kinder Morgan's erroneous contention that the FSA gives it the right to use unapproved prices or values without disclosure to or approval from the Royalty Owners. This theory is both wrong and illogical, and the Court of Appeals properly rejected it.

The FSA recognizes a procedure under which the narrow arbitration provision in Section 16 would operate. If Kinder Morgan wished to modify the parties' agreed methodology, it would disclose to the Royalty Owners that it wished to use one or more other benchmarks or Non-Qualified Contracts, and provide the terms of those contracts and any new or other benchmarks to the Royalty Owners for review. The Royalty Owners would then have an opportunity to agree to the use of the prices or values under Non-Qualified Contracts, or to object. If the parties could not agree on the use of prices or values under Non-Qualified Contracts, then either party could invoke Section 16 by serving a demand that "sets forth the matter or matters to be submitted and the name of the arbitrator." Pet. App. 102-03.

In fact, it is Kinder Morgan's construction of the FSA that seeks to render significant portions of the FSA. Kinder Morgan would have this Court adopt a

construction of the FSA that would permit Kinder Morgan to depart from the methodology approving valuation based on the volume weighted average prices of Qualified Contracts and use undisclosed prices and values that had never been approved by the Royalty Owners. This is the very scenario the FSA was intended to prevent. Kinder Morgan's interpretation would allow it to unilaterally reduce the benefits to which Royalty Owners are entitled without Court Approval in violation of Section 55 of the FSA.

D. The Court Of Appeals Applied The Proper Test To Determine Arbitrability.

Even if the Court were to ignore basic rules of contract construction and the exclusionary language of Section 16, the Royalty Owners' claims would not be subject to arbitration. The Court must compare the allegations of the Complaint to the arbitration provision the parties adopted to determine if the claims are subject to arbitration. The only claims subject to arbitration are claims involving prices or values under Non-Qualified Contracts or Non-Qualified Other Transportation Charges. There is no such claim in the Class Action Complaint. Pet. App. 27-44.

The Court of Appeals reached the correct conclusion below because the Section 16 arbitration provision is indeed narrow. It does not contain a general arbitration provision under which the parties agreed to arbitrate all disputes arising from the FSA. See

McDonnell Douglas, supra, 858 F.2d at 831. As the Court of Appeals properly recognized, the fact that the arbitration provision in Section 16 is narrow has ramifications for its interpretation and application. When a narrow arbitration provision is involved, arbitration will not be compelled where the dispute is one the parties excluded from arbitration. *New York News, Inc. v. Newspaper Guild of New York*, 927 F.2d 82, 83-4 (2d Cir. 1991); *Chevron USA Inc. v. Consolidated Edison Co. of N.Y.*, 872 F.2d 534, 538 (2d Cir. 1989) (although a narrow arbitration clause must be construed in light of the presumption favoring arbitration, "the court is not free to disregard the explicit boundaries set by the agreement between the parties").

The complaint does not mention Non-Qualified Contracts or Non-Qualified Other Transportation Charges. Pet. App. 27-44. The most Kinder Morgan can argue is that the Royalty Owners challenge the result of the net-back pricing methodology Kinder Morgan utilized. But that only implicates the failure of Kinder Morgan to adhere to Section 14 and subsections (a), (b) and (c) of the FSA – a breach of contract and related implied covenants.

The possibility of a dispute arising over royalty calculation and payments was foreseeable when the FSA was negotiated and executed in 1998. The parties did not agree to a broad arbitration provision to cover any such dispute. The fact that they did not, and expressly excluded future claims for breach of the FSA, compels the conclusion that the Royalty Owners'

claims are not subject to arbitration. *McDonnell Douglas, supra,* 858 F.2d at 832 (narrow arbitration clause must be carefully applied to carry out limited intent of parties).

E. Disputes Over Prices For Unit Co_2 Do Not Necessarily Implicate Non-Qualified Contracts.

Kinder Morgan argues that the Royalty Owners' claims must involve disputes regarding the price or value under Non-Qualified Contracts because prices or values under Qualified Contracts are not open to dispute. This contention misses the point. It also ignores the true nature of the Royalty Owners' breach of contract claims based on Kinder Morgan's failure to follow the Section 14 methodology for calculating royalty. The test for arbitrability is based upon the actual allegations of the Complaint, not Kinder Morgan's characterization of what the claims must "of necessity" be "predicated upon."

Even if the Court were inclined to look behind the allegations of the complaint, it is obvious that there are a variety of circumstances which would involve claims for royalty underpayment unrelated to prices or values under Non-Qualified Contracts. Kinder Morgan may use its very low CO_2 prices based simply on how it designs its expense economics for its EOR business. Examples in the record include Kinder Morgan deducting a transportation charge in excess of that authorized by the FSA, and failing to use

correct values under Qualified Contracts. Resp. App. 13-14.

Moreover, if Kinder Morgan used other benchmarks, such as pricing Unit CO_2 based on its EOR budget, or on its cost of production, etc., claims for underpayment based on that conduct would not involve Non-Qualified Contracts. Even if Non-Qualified Contracts were in place, the evidence may demonstrate that those contracts were not arms-length contracts, or were illusory or sham agreements designed to provide cover for a price Kinder Morgan unilaterally set for royalty purposes, or that a contract sets a "price" but no volumes of Unit CO_2 were really sold under the contract.

Kinder Morgan unilaterally divides the universe of prices or values that might be used in determining royalty settlement values into two categories: Qualified Contract prices and Non-Qualified Contract prices. The FSA does not support this dichotomy. The FSA recognizes three potential sources of prices or values: Qualified Contracts, Non-Qualified Contracts, and other benchmarks. Pet. App. 98-102. The terms "other benchmarks" and "Non-Qualified Contracts" are not synonymous, and the parties to the FSA recognized a distinction between the terms. Disputes regarding other benchmarks that are not prices or values under Non-Qualified Contracts are not subject to arbitration. Prices or values not based on Qualified Contracts are not by default prices or values under Non-Qualified Contracts.

The Court of Appeals did include in its opinion statements to the effect that the Royalty Owners claimed that the use of Non-Qualified Contracts constitutes a breach of the FSA. Pet. App. 4, 5, 12. The Royalty Owners cannot explain why the Court of Appeals included those statements, because they do not represent the breach of contract theory at issue in this case. The Court of Appeals near the end of the opinion seems to contradict these earlier statements by concluding that "it is inappropriate to compel arbitration when Plaintiffs may not dispute the prices under non-qualified contracts at all." Pet. App. 18. In any event, these statements in the opinion below do not affect the arbitrability analysis or compel a different result. The parties to the FSA expressly provided that the exclusion for claims for breach of the FSA would control in the event of a conflict between the exclusion and the narrow arbitration provision.

II. There Is No Split Between Lower Courts For This Court To Resolve.

Because a court's first inquiry in a dispute as to arbitrability of certain claims is to determine the intent of the parties based upon the language of the agreement, all courts necessarily examine the scope of an arbitration provision. All courts recognize a distinction between narrow and broad arbitration clauses. All courts employ a similar analysis in determining these issues. Some jurisdictions have expressly stated a rule that the presumption favoring arbitration is less applicable to a narrow arbitration

clause than to a broad arbitration clause. These jurisdictions are cited in the Petition at pp. 15-16, fn. 10-15. This distinction traces back to this Court's *AT & T* decision, which expressly recognized that the presumption of arbitrability is particularly applicable with respect to broad arbitration clauses. 475 U.S. at 650.

While the New Mexico Court of Appeals cited to some of these cases and noted that the arbitration clause at issue was narrow, it did not hold that the presumption favoring arbitration was inapplicable. Pet. App. 8-10. Instead, as to the contract claims, the Court of Appeals held that claims for breach of the settlement agreement are "not subject to arbitration" under the unambiguous language in Section 16. Pet. App. 13. This result is consistent with the rule announced by this court that where the parties have clearly expressed their intent to exclude certain claims from the scope of arbitration, those exclusions are effective. *Mitsubishi Motors, supra.*

Kinder Morgan points out that while some jurisdictions appear to require that a claim must "on its face" fall within the preview of a narrow arbitration clause in order to support a motion to compel arbitration, other jurisdictions draw no distinction between narrow and broad arbitration clauses in applying the presumption in favor of arbitration.[4] Petition,

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[4] Kinder Morgan cites the Fifth Circuit as a circuit that does not distinguish between broad and narrow arbitration

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pp. 18-22. A review of those decisions indicates that the differences in language are semantic differences that do not affect the substantive analysis all courts apply to arbitration questions based on the rules announced in the decisions of this Court.

While the New Mexico Court of Appeals cited numerous cases, including cases from the Tenth Circuit Court of Appeals, that recognized the distinction between broad and narrow arbitration clauses, the Court below did not base its ruling on the restrictive test Kinder Morgan emphasizes in its Petition. Instead, the New Mexico Court of Appeals based its ruling on the unambiguous exclusion from arbitration in the FSA that provides that the "provision concerning arbitration . . . shall, in no event, apply to any future claims for breach of this Agreement."

The Court's decision below represents a reasoned and correct application of the rules for determining arbitrability. The favorable construction rules are limited when the court is reviewing a narrow, rather than a broad arbitration provision. *Cummings v. Fed Ex Ground Package System, Inc.*, 404 F.3d 1258 (10th Cir. 2005); *McDonnell Douglas, supra,* 858 F.2d at 832; *Simon v. Pfizer, Inc.*, 398 F.3d 765, 775 (6th Cir. 2005). When an arbitration clause extends only to a specific type of dispute, a court cannot require

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provisions. However, the Fifth Circuit does recognize the distinction. *Complaint of Hornbeck Offshore (1984) Corp. v. Coastal Carriers Corp.*, 981 F.2d 752, 754-55 (5th Cir. 1993).

arbitration of claims that are not included because arbitration is a matter of contract. *Id.* Application of these universal rules does not subvert the FAA in any way. Any other result would allow the presumption in favor of arbitration to rewrite the parties' agreement.

Kinder Morgan also claims that the New Mexico Court of Appeals decision conflicts with law in the Fourth Circuit Court of Appeals, citing *Choice Hotels Intern., Inc. v. BSR Tropicana Resort, Inc.*, 252 F.3d 707, 700 (4th Cir. 2001). That is wrong because *Choice Hotels* involved a broad arbitration provision that provided for arbitration of "any controversy or claim relating to this Agreement, or the breach of this Agreement" subject to three exceptions. 252 F.3d at 710.

The question in *Choice Hotels* involved whether the dispute involved an action for collection of moneys owed under the agreement, an exception to the broad arbitration provision. The Court held that the claim for breach of the franchise agreement was not a collection action under the exception to the broad arbitration provision, thus was subject to arbitration. 252 F.3d at 711. The Court also held that the claim to collect the affiliation fee was a collection action not subject to arbitration. *Id.* at 712. There is no conflict between the two decisions. Even if there were a dispute between the New Mexico Court of Appeals decision and a decision from the Fourth Circuit Court of Appeals, that is a conflict that this Court need not resolve. New Mexico courts are not bound by Fourth Circuit precedent.

III. Royalty Owners Have Not Utilized "Artful Pleading" To Avoid The Narrow Scope Of The Section 16 Arbitration Provision.

Kinder Morgan contends that the Court of Appeals fell victim to "artful pleading" by the Royalty Owners in an effort to hide the true nature of their claims in this case to escape the narrow arbitration provision. There is no support in this record for this contention. This has always been a case of breach of the FSA. Kinder Morgan never explains why the Royalty Owners would initially serve a complaint in arbitration, then withdraw it after the Unit Operator complained that the claims were covered by the Section 16 exclusion, and refile the same substantive claims in this lawsuit, if the Royalty Owners were attempting to avoid arbitration by artful pleading.

The claim that Kinder Morgan failed to pay royalties based on the FSA formula in Section 14(c) is a claim for breach of contract that is expressly excluded from arbitration in Section 16. Consequently, Kinder Morgan cannot rely on the complaint to support arbitration. Kinder Morgan fixates on the Royalty Owners' statements in a motion to compel discovery. Petition, p. 10. The Royalty Owners filed a motion to compel because Kinder Morgan refused to produce relevant documents in response to discovery requests. When the Royalty Owners filed their motion, they had none of the underlying contracts Kinder Morgan represented it used to calculate royalties. They did not know precisely how Kinder Morgan calculated royalties. They had only Kinder

Morgan's representations about the methodology provided in support of its motion to compel arbitration. However, even in this pleading, the Royalty Owners confirmed that "The primary thrust of the complaint is that Kinder Morgan has breached the Feerer Settlement Agreement in the manner and method by which it fails to honor its royalty obligations." Pet. App. 73-74.

CONCLUSION

The Court of Appeals decision in this case gave effect, as it must, to the agreement between the parties that claims for breach of the FSA would not be subject to arbitration. The reams of paper used in addressing this issue cannot change the language of Section 16. The federal policy in favor of arbitration does not modify or override the parties' agreement that claims for breach of the FSA are not subject to arbitration.

The Courts are fond of touting arbitration as an economical and efficient means of dispute resolution. Here, Kinder Morgan has turned a narrow arbitration provision into a vehicle to litigate its motion to compel arbitration in the New Mexico district court, the Court of Appeals, the New Mexico Supreme Court, and now this Court. Merits discovery and substantive resolution of the claims have been derailed for over three years. The Royalty Owners

respectfully request that this Court deny Kinder Morgan's Petition.

Respectfully submitted,

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STATE OF NEW MEXICO
COUNTY OF UNION
EIGHTH JUDICIAL DISTRICT

J. CASPER HEIMANN, PECOS SLOPE ROYALTY TRUST and RIO PETRO LTD., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico similarly situated,

Plaintiffs,

vs.

KINDER-MORGAN CO2 COMPANY, L.P.,

Defendant.

No. 04-26 CV

(Filed Feb. 23, 2005)

PLAINTIFFS' SUPPLEMENTAL BRIEF IN OPPOSITION TO DEFENDANT'S MOTION TO COMPEL ARBITRATION

The plaintiffs submit this supplemental brief in opposition to the defendant's Motion to Compel Arbitration and Stay Proceedings.

I. INTRODUCTION

When the plaintiffs filed a demand for arbitration on July 26, 2004, withdrew that demand, and on August 3, 2004[1] filed and served their complaint herein, they knew nothing about how Kinder-Morgan was calculating royalty payments to the plaintiffs. The extent of plaintiffs' knowledge was that since 2000 there was and continues to be a remarkable and increasing disconnect between the Bravo Dome CO2 values and the historically high and increasing price of Permian Basin crude oil.

Kinder-Morgan filed the subject motion on September 28, 2004 attaching documents identified as Exhibits 1 through 12. Exhibit 11 was the Affidavit of Dr. Stephen Becker who had the benefit of access to the defendant's records and contracts and offered the opinion that the plaintiffs' claims raised a claim against Non-Qualified Contracts and Non-Qualified Other Transportation charges covered by the Settlement Agreement Section 16 arbitration provision.[2]

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[1] Two days after July 26, 2004, plaintiffs were served with the Oxy USA Complaint for Declaratory Judgment in Chaves County alleging that plaintiffs' claim is for breach of the Feerer Settlement Agreement "a claim specifically excluded from arbitration by the last sentence of the arbitration provision." Oxy Complt.¶ 11.

[2] In fashioning the Settlement Agreement the parties made lists of existing contracts for the sale or other disposition of Unit CO2 that were approved for use by the lessees. Those contracts were called "Qualified Contracts." In the case of Kinder-Morgan (f/k/a Shell) the approved contracts are listed on Exhibit D-3 to

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The plaintiffs responded on October 18, 2004 stating their opposition to the motion and that "Discovery is necessary to allow the class to determine exactly how the royalties are calculated and to identify all the issues which the class contends constitute breaches of the Settlement Agreement contributing to the underpayment of royalties." Plaintiffs' Response 15.

Limited discovery began with production by defendant of some CO2 sales contracts in mid-November 2004. Other contracts were produced in December and requested additional documents were provided as recently as last week, on February 18, 2005. The deposition of defendant's witness Dr. Stephen Becker was taken in Austin, Texas on Friday, February 18, 2005.[3] Now that plaintiffs have had an opportunity to tediously examine the evidence from Kinder-Morgan, and now that those documents and Kinder-Morgan's affidavits and exhibits have been reviewed by plaintiffs' expert witness, George Donkin, there are important determinative points and analysis to be considered by the Court on the Motion to Compel Arbitration. A copy of Mr. Donkin's Affidavit,

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the Settlement Agreement. All contracts entered into by Kinder-Morgan after the date of the Agreement are called "Non-Qualified Contracts."

[3] This document production by Kinder-Morgan has only been partial with respect to the range of documents requested by plaintiffs in September, 2004. Plaintiffs have filed a Motion to Compel additional documents, which motion was filed on December 10, 2004. That motion is also scheduled to be heard on February 24, 2005.

offered in opposition to the Motion to Compel Arbitration, is attached hereto as Exhibit A. The Stephen Becker Affidavit is attached as Exhibit B-1 and referenced portions of the Stephen Becker deposition are attached as Exhibit B-2. Attachment Exhibit C is a copy of Exhibit 8 to Stephen Becker's deposition listing the contracts used by Kinder-Morgan to calculate the subject royalties categorized as either Qualified or Non-Qualified.

II. THE AGREED CO2 PRICE BENCHMARKS – SECTION 14(a), (b) AND (c)

The prior federal court class action litigation by the Bravo Dome private royalty and override owners against Amoco Production Company, Amerada Hess, Shell and Exxon was concluded by the Settlement Agreement filed with the federal court on April 1, 1998. Exhibit "A" to the Complaint. The plaintiffs and the class received two forms of consideration under that Agreement. One was cash payments totaling about $47,500,000. The other was a specified methodology to be used by the Bravo Dome working interest owners in the calculation of future royalty payments beginning January 1, 1998.

As relevant to this case, the approved ongoing payment method[4] specified in Section 11 of the

[4] The Settlement Agreement prohibits the reduction of royalty for the expense of Unit gathering, dehydration and compression. That is not believed to be an issue here.

Settlement Agreement set a limit on deduction from royalty for certain services in transporting the compressed CO2 from the Bravo Dome to the enhanced oil recovery (EOR) fields. Section 12 mandates that the price under a certain "1994 Contract" between Amoco and Amerada Hess "shall not be used by Defendants as a benchmark for calculating royalties . . . ", Section 13 specifies that while a company can use the weighted average price of CO2 volumes it sells or takes in-kind it cannot factor in the prices and volumes of other Unit working interest owners, i.e., it precludes use of a "Unit" weighted average price.

Finally, and most importantly,. Section 14 of the Agreement sets-out the approved CO2 pricing methodology. The previously noted sections of the Settlement Agreement each state prohibitions on royalty calculation by the working interest owners. Conversely, Section 14 (pages 22-25 of the Agreement, attached as Exhibit D) states a positive, to wit: The working interest owners "**will utilize** the royalty settlement methodology and the identified **benchmarks**[5] **set forth in paragraphs (a), (b) and (c)** below for the purpose of calculating and paying royalty to the Respective Owners, **which methodology, benchmarks and resulting payments are hereby agreed to and approved** by Amoco's, Hess'

[5] "bench marks" – a standard in measuring. *Webster's New World Dictionary,* (3d Ed.).

and Shell's Respective Owners [royalty payees]." Emphasis added. The approved benchmarks are:

(a) The subject is Bravo Dome CO2 volumes;

(b) The companies will use weighted average prices "for their respective sales or other dispositions of Unit CO2 . . .

(c) Kinder-Morgan and the other companies will use the "prices or values established in **their respective Qualified Contracts** . . . their respective transportation charges established as **Qualified Other Transportation Charges** . . . and their respective **Approved Mainline Deductions** . . . " Emphasis added.

The approved and agreed benchmarks **do not** include CO2 prices under Non-Qualified Contracts nor the use of Non-Qualified Transportation Charges. That is to say, what was approved, logically enough, was use of the known and approved contracts.

Section 14(c) concludes by stating that there is no agreement on whether future benchmarks that may be used in the future for royalty settlement are or are not proper.

III. ARBITRATION PROVISION

The arbitration provision in Section 16 of the Settlement Agreement is narrow. It applies only to "**claims . . . asserted** against . . . [Kinder-Morgan] regarding (a) the price or value under Non-Qualified

Contracts ... Unitilized by ... [Kinder-Morgan] in establishing royalty settlement values ... ". Expressly excluded from the arbitration provision are "**any future claims for breach of this agreement.**"

IV. THE LEGAL STANDARDS

A. The Contract

As a contractual remedy, arbitration clauses are governed by contract law. *Santa Fe Technologies Inc. v. Argus Network Inc.*, 2002-NMCA-030, ¶ 52, 131 N.M. 772, 788, 42 P.3d 1221; *Casias v. Dairyland Ins.*, 1999-NMCA-046, ¶ 11, 126 N.M. 772, 975 P.2d 385. A court will not rewrite a contract for the parties and, in its interpretation, the court will apply the plain meaning of the contract language. *Santa Fe Technologies, supra.*

Whether the parties have agreed to arbitrate is a question of law. *Casias*, 1999-NMCA-046, ¶ 13, 126 N.M. 772; NMSA 1978 § 44-7A-7(b). Therefore, the court's inquiry is whether the parties have agreed to arbitrate the matter under dispute. *Santa Fe Technologies, supra.*[6] The law requires a close connection

[6] The fact that the arbitration provision is very narrow has ramifications for the interpretation and application of that provision. When a narrow arbitration clause is at issue, arbitration will not be compelled unless the dispute falls precisely within the terms of the clause. *New York News, Inc. v. Newspaper Guild of New York*, 927 F.2d 82, 83-4 (2nd Cir. 1991). See also *Chevron USA Inc. v. Consolidated Edison*, 872 F.2d 534 (2nd Cir. 1989) (even though a narrow arbitration clause must

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between the subject matter of the agreement and the subject matter of the dispute. *Santa Fe Technologies*, 131 N.M. 789.

The terms of a contract cannot be changed unilaterally by one party; there must be mutuality. *Heye v. American Golf Corp. Inc.*, 2003-NMCA-138, ¶ 12, 134 N.M. 558, 562, 80 P.3d 495 ("A valid contract *must* possess mutuality *of* obligation"); *Discover Bank v. Shea*, 362 N.J.Super. 200, 827 A.2d 358 (2001) (New Jersey courts do not permit unilateral amendments to existing agreements to change material terms, invalidating Bank's attempt to amend credit card agreement to require arbitration of disputes by sending its customers a "bill stuffer" notifying them of arbitration clause); *Guy Pine, Inc. v. Chrysler Motors Corp.*, 201 Kan. 371, 440 P.2d 595 (1968) (one party to contract cannot unilaterally change the terms, there must be mutuality). The New Mexico Supreme Court characterized a contract that allowed one party, the employer, to unilaterally modify the terms "illusory," and refused to enforce an arbitration provision in the contract. *Salazar v. Citadel Communications Corp.*, 2004-NMSC-013, 135 N.M. 447, 450, 90 P.3d 466:

> Under general New Mexico contract law, an agreement that is subject to unilateral modification or revocation is illusory and unenforceable. *Bd. of Ethic. v. James Hamilton*

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be construed in light of the presumption favoring arbitration, the court is not free to ignore explicit boundaries set by the parties' agreement).

Constr. Co., 119 N.M. 415, 420, 891 P.2d 556, 561 (Ct. App. 1994). This principle applies equally to agreements to arbitrate. *Heye*, 2003-NMCA-138, ¶¶ 11-12, 134 N.M. 558, 80 P.3d 495.

B. The Plaintiffs' Complaint

The critical Section 16 arbitration provision is confined to "Any **claims asserted** by Plaintiffs or members of the Class . . . regarding (a) the price or value under Non-Qualified Contracts . . ." Emphasis added.

Whether a claim falls within the scope of an arbitration agreement turns on the factual allegations in the complaint. *Gregory v. Electro-Mechanical Corp.*, 83 F.3d 382, 384 (11th Cir. 1996); *P&P Industries, Inc. v. Sutter Corp.*, 179 F.3d 861, 871 (10th Cir. 1999); *Santa Fe Technologies*, 131 N.M. at 789 ("When we hold SFT's claims up against the Agreement, we do not see overlap").[7]

[7] Kinder-Morgan cites the same rule in its Reply (at 3) on the subject motion, but then ignores the fact that the plaintiffs' factual allegations in the Class Action Complaint allege absolutely nothing concerning Non-Qualified Contracts, or for that matter, Qualified Contracts.

V. EXPERTS' ANALYSIS OF THE AGREEMENT

The definitive interpretation of the language of the Settlement Agreement lies with the Court as a question of law. Each side, however, provides a reading and interpretation by expert consultants. Each expert does so in the context of these undisputed facts:

1. The written words of the Settlement Agreement approve only one mutually agreed source of CO2 values, those based on Qualified Contracts and approved transportation deductions. Section 14(c).

2. For the time period material to this case Kinder-Morgan has used CO2 prices from non-approved, Non-Qualified Contracts mixed with approved contract prices to determine and pay royalty.

3. The changed benchmark of mixing Non-Qualified contract prices with Qualified contract prices was implemented unilaterally by Kinder-Morgan without knowledge, participation or approval by the royalty owners or their representatives.

4. The monthly remittance statements sent by Kinder-Morgan to royalty owners provide no information as to what contract prices are used in royalty calculation. See sample of J. Casper Heimann statements attached as Exhibit E.

Stephen Becker Opinion – Defendant's Witness

Since Section 14(c) does not include Non-Qualified Contracts, defendant's expert Dr. Stephen Becker believes that it "contemplates [CO2 prices are] to result from a mix of both Qualified and Non-Qualified downstream contract prices . . . " The missing wording is thus supplied by opinion as being "contemplated." Becker Affd. ¶ 4, Ex B-1. In his deposition Dr. Becker changed his word selection from "contemplates" to "it is clear to me that 14(c) anticipates that there will be qualified contracts and non-qualified contracts . . . the way they laid it out it clearly anticipates that – the use of things other than qualified contracts." Dep. 51, 52 Ex. B-2 attached. He considers the terms "contemplates" and "anticipates" as synonymous. Dep. 54, *Id.* He concedes, as he must, that the words 'non-qualified contract' do not appear in 14(c), Dep. 54, *Id.*, while the qualified contracts were expressly approved by the express wording of the subparagraph. Dep. 54, Ex. B-2. When a royalty owner, such as Casper Heimann, looks at his check stub there is nothing that would tell him what contracts, qualified or non-qualified, were being used by Kinder-Morgan. Dep. 58, Ex. B-2.

Dr. Becker testified that when non-qualified contracts begin to be used by defendant in the royalty calculation that practice constitutes the use of another "benchmark." "So, yes, it would be a benchmark different from the price, the price or value you'd see under qualified contracts." Dep. 67, 68, Ex. B-2.

Q. So the other benchmark, then, can come into use unilaterally; that is to say, simply by Kinder-Morgan deciding it's going to use some non-qualified contracts, it can initiate another benchmark for calculation of the royalty?

A. Yeah. I mean, I wouldn't characterize it as "initiate another benchmark" because in may kind it leaves a reader with the impression that you've done this whole sale change from when we were doing it this way, and we unilaterally decided to pick up and go value it on this other thing. The use of prices and values obtained under non-qualified contracts is a benchmark different from those that you get from qualified contracts. And I would agree that per the terms of the settlement agreement, I don't see anything that says that Kinder-Morgan has to get permission from anyone to begin using non-qualified contracts, nor do I see anything in here that requires that Kinder-Morgan provide any notice that it's doing so. The settlement agreement anticipates that it's going to be done in my reading of it. But I don't see any approval step called for here.

* * *

Q. Right. In other words, unilaterally that can be done?

A. Yes.

Dep. 68, 69, Ex. B-2.

George Donkin – Plaintiffs' Witness

Mr. Donkin is an experienced natural gas economist who has worked on many prior lawsuits involving claims by royalty owners of underpayment on CO2 produced from the Bravo Dome and the McElmo Dome in southwest Colorado. His affidavit is attachment Exhibit A.

Section 14(c) of the Settlement Agreement shows that the parties agreed "only to the use of known, existing and identified contracts for sale or disposition of CO2 and specifically did not agree to the use of Non-Qualified Contracts in the agreed methodology for calculating settlement royalty values." Aff. Donkin, ¶ 16, Ex. A.

The conclusion of Dr. Becker that royalty values are to result from a mix of qualified and non-qualified contracts is incorrect. As Mr. Donkin puts it: "In my experience, sales agreements in the petroleum industry do not 'contemplate' how things are to be done, i.e, they say what they mean." Aff. Donkin, ¶ 17, Ex. A. He believes it is only logical that the parties to the Settlement Agreement would never agree to have their royalty paid on the basis of unknown future benchmarks "using volumes and prices in unknown future CO2 sales agreements." Aff. Donkin, ¶ 18, Ex. A.

Mr. Donkin concludes that for the period January 2000 to July 2004 Kinder-Morgan has failed to arrive at the royalty value using the methodology called for

by the terms of the Settlement Agreement. In addition to that departure from the contract, upon the limited discovery available, it appears to Mr. Donkin that Kinder-Morgan failed to honor the Settlement Agreement terms in other ways:

a) using mainline transportation deductions in excess of $0.11 per Mcf for CO2 gas to the Seminole San Andres Unit by use of a $0.09 "meter fee" and $0.025 additional tariff;

b) lowering the stated per Mcf price for supplies of CO2 by obtaining non price consideration in the form of a transfer of a buyer's property interest in an EOR project in one contract and in another by obtaining a right to process the natural gas produced from a CO2 buyer's EOR field;

c) and failing to apply the oil formula price plus a minimum price ($0.625) on a certain Qualified Contract so that for years a CO2 value of 57¢ or 58¢ was used for royalty until the price was finally corrected in April 2004 to $1.039 and in July 2004 to $1.15 per Mcf.

VI. CONCLUSION

"A court will not rewrite a contract for the parties and, in its interpretation, the court will apply the plain meaning of the contract language." *Santa Fe Technologies,* 131 N.M. 788. The same must be said for a party's complaint.

In order to try to fit this case into the narrow confines of the Section 16 arbitration provision, Kinder-Morgan seeks by opinion testimony to rewrite Section 14(c) so that the express omission of non-approved contracts might be overcome because their inclusion was supposedly "contemplated." Defendant would have the Court accept that it can use the Non-Qualified Contracts, change the Settlement Agreement's approved pricing benchmarks, and do all of that unilaterally without breaching the Agreement. Breaches of the Agreement, of course, are expressly excluded from the Section 16 arbitration provision.

Even reading into the Settlement Agreement wording that does not exist fails to get the defendant to its desired result. It must also morph the plaintiffs' Complaint and even morph the legal standard by which the Complaint is to be read. According to defendant, the August 3, 2004 Class Action Complaint supposedly states "claims asserted" (Section 16) about prices under non-qualified contracts. The Complaint contains no such allegation. In fact what plaintiffs have alleged concerning royalty payments by Kinder-Morgan during 2000-2004 is fairly summarized, viz:

- Given the direct, functional and economic connection between Unit CO2 and oil and gas produced by its use in EOR projects and the growing demands for CO2 "the values set by the defendant for payment of the subject Royalty Interests

are patently and significantly improper." Complt. ¶ 27.

- "Kinder-Morgan has concealed the improper basis upon which the royalty calculations are made and the actual economic consequences and benefits enjoyed by it which economic benefits are not and have not been shared by Kinder-Morgan with the royalty Interest Owners." Complt. ¶ 30.

"When we hold [plaintiffs'] claims up against the Agreement, we do not see overlap." *Santa Fe Technologies,* 131 N.M. 789. What one does see is that Section 16 by its own terms does not "apply to any future claims for breach of this Agreement," (Section 16) and claims of such breaches are precisely what is alleged by the plaintiffs.

The defendant in its briefing must make yet one more distortion of the written word. In its Reply on this motion defendant first recites the rule, as did plaintiffs above, p.7, that whether a case falls within the scope of an arbitration agreement depends on the factual allegations of the complaint. *Gregory, supra; P&P Industries Inc., supra; Santa Fe Technologies, supra.* The problem for defendant is that the written allegations of the Complaint are of absolutely no help to it. So defendant turns the rule on its head by arguing "What is relevant is the underlying factual basis for the claims." Reply 3. There is no legal support cited by defendant for this contention and none is to be found.

The written terms of the Settlement Agreement, the allegations of the Complaint, and the applicable law all stand against the motion to compel arbitration. The motion must be denied.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have caused a true and correct copy of the foregoing Plaintiffs' Supplemental Brief in Opposition to Defendant's Motion to Compel Arbitration to be served on this 22nd day of February, 2005, to the following counsel of record:

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VIA FACSIMILE

/s/ J.E. Gallegos
J.E. Gallegos

STATE OF NEW MEXICO
COUNTY OF UNION
EIGHTH JUDICIAL DISTRICT

J. CASPER HEIMANN, PECOS SLOPE ROYALTY TRUST and RIO PETRO LTD., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico similarly situated,

Plaintiffs,

vs. No. D-818-CV-2004-00026

KINDER-MORGAN CO2 COMPANY, L.P.,

Defendant.

AFFIDAVIT OF GEORGE L. DONKIN

STATE OF VIRGINIA)
) ss:
COUNTY OF ARLINGTON)

1. My name is George L. Donkin. I am a Vice President, employed by J.W. Wilson & Associates, Inc., ("JWWA") Rosslyn Plaza C, Suite 1104, 1601 North Kent Street, Arlington, Virginia 22209. I hold B.A. and M.A. degrees in economics from the University of Maryland, where my major fields of study were economic theory, industrial organization, and antitrust economics. I am a consulting economist specializing in energy economics and public policy toward business. I have

nearly thirty-five years of experience as an energy economist, both as a consultant and a staff economist at the Federal Power Commission, the predecessor of the Federal Energy Regulatory Commission ("FERC"). Since 1974, I have been employed as a consulting economist representing various clients, including federal agencies, state regulatory commissions, numerous state consumer advocate offices, public and private utility companies, industrial firms, natural gas producers, gas pipelines, gas marketers, local natural gas distribution companies, and non-profit organizations. My professional work has pertained to a wide range of issues concerning the natural gas and petroleum industries, public utility regulation, energy policy, antitrust issues, and economic research and analysis. I have presented expert testimony in over one hundred thirty proceedings before numerous state and federal courts, before the FERC, and before various state public utility commissions. I have also testified as an energy expert in arbitration proceedings in Louisiana, New Mexico and Texas, before a Mediator in Ohio, and in Federal bankruptcy court. Attachment A identifies my prior expert testimony in other proceedings.

My Assignments

2. JWWA has been retained by the Plaintiffs in this litigation to analyze the Defendant's pricing and royalty payment practices for

carbon dioxide ("CO_2") gas produced from the Bravo Dome CO_2 gas unit in Northeast New Mexico. The Complaint of the Plaintiffs alleges that Kinder-Morgan is in breach of contract by underpaying the royalties and overriding royalties to private owners. As part of this analysis, we have been asked to:

a) Consider the claims of the Plaintiffs in their Class Action Complaint in the context of the terms of the Class Action Settlement Agreement in *Feerer et al. v. Amoco Production Co.* ("Settlement Agreement") and in that connection respond to the opinion testimony of Dr. Stephen Becker in his affidavit that the Plaintiffs' claims are not in breach of the Settlement Agreement but are challenges to Non-Qualified contracts or Non-Qualified Other Transportation Charges and must be submitted to arbitration.

b) Determine, among other things, the extent to which the CO_2 values used by Kinder-Morgan CO_2 Company to pay royalties to the Plaintiff, have reflected the value of CO_2 at the tailgate of the Bravo Dome plant, in conformance with the terms of the Settlement Agreement.

c) Evaluate the validity of the Kinder-Morgan transportation deductions from CO_2 prices in the Permian Basin in arriving at the imputed prices at Bravo Dome that were used to pay royalties to the Plaintiffs.

3. I am being compensated for my work, on this matter, on a time and expenses basis. My hourly rate is $250.

Related CO_2 Experience

4. Prior to and in connection with the consulting services being provided in this case, JWWA has made detailed studies of the production, transportation, and sale of compressed CO_2 for use as an injectant in enhanced oil recovery (EOR) projects. This prior experience includes the following:

   a) *Doris Feerer, et al. v. Amoco Production Company, et al.,* in the United States District Court for the District of New Mexico, case No. 95-0012-JC/WWD. Following the preparation and submission of expert reports in the Feerer case, Dr. John W. Wilson, President of JWWA, and I gave deposition testimony, and we were both designated by the Plaintiffs' attorneys as experts to give testimony at trial.

   b) *CO_2 Claims Coalition, LLC v. Shell Oil Company, et al.,* in the United States District of Colorado, case No. 96-Z-2451. The Plaintiffs in that case were the small share working interest owners, and a number of the fee royalty interest owners and overriding royalty interest owners in the McElmo Dome CO_2 field in Colorado: The Plaintiffs' claims in the McElmo Dome CO_2 litigation were also

similar to those being made by the Plaintiffs in this case.

c) *Gary H. Shores, et al. v. Mobil Oil Corporation, et al.,* in the Probate Court of Denton County, Texas, case No. GC-99-01184. The Plaintiffs in that case are a number of the fee royalty interest owners and overriding royalty interest owners in the McElmo Dome CO_2 field in Colorado. Their claims are similar to those being made in the other McElmo Dome CO_2 litigation.

d) *Ray Powell, Commissioner of Public Lands of the State of New Mexico, Trustee v. Amoco Production Company, et al.,* in the First Judicial District, State of New Mexico, County of Santa Fe, Case No. D-0101-CV-2000 02079 ("the State of New Mexico case"). In that case, the State of New Mexico, as a fee royalty interest owner in the Bravo Dome CO_2 field, made claims similar to those that have been made in the other CO_2 cases, including the claims being made by the Plaintiffs in this litigation. I gave deposition testimony and was designated as an expert witness by the Plaintiff's attorneys to testify at trial in the State of New Mexico case.

Other Related Experience

5. JWWA has had an active and ongoing practice for over thirty years in economic consulting in the oil and gas business, including crude oil and natural gas production, petroleum and natural gas pipeline operations, and the sale of petroleum and natural gas. We are generally familiar with the economic conditions that have influenced domestic petroleum markets since the 1970's, and especially during the time period covered by the Plaintiffs' claims in this case. I am familiar with the terms, concepts, practices, and methodologies that are generally and customarily used in the oil and gas business, including planning, operations, and the methods and procedures that are generally and customarily relied upon to measure economic values in the various domestic petroleum and natural gas markets.

Background on CO_2 Operations

6. Enhanced oil recovery, or EOR, refers to the methods used to obtain incremental oil production from crude oil reservoirs over that which can be economically recovered by conventional primary and secondary recovery methods. Primary methods rely on natural reservoir pressures or energy to drive the crude oil to the surface. But over time, this natural energy drive declines, and other energy must be added if significant additional crude oil is to be produced.

7. The Permian Basin producing area in West Texas and Southeast New Mexico is one of the most mature domestic crude oil producing areas. Given the physical characteristics of its reservoirs, the Permian Basin was long considered a prime candidate for EOR operations, including CO_2 miscible flooding. These facts, in combination with its relatively close proximity to three large CO_2 source fields in Northeast New Mexico and Southwest and Southeast Colorado, eventually resulted in the development in the 1980's of large-scale, commercial CO_2 for EOR operations in the Permian Basin crude oil industry.

8. Kinder-Morgan is one of only a few major participants in the CO_2 for EOR industry in the Permian Basin. Moreover, each of the largest owners of CO_2 at the three source fields has also been significantly involved in both the ownership of the three pipelines used to transport CO_2 from the source fields to the EOR fields, and in the EOR operations at those same oil fields in the Permian Basin.

9. The Permian Basin EOR area has obtained nearly all of its CO_2 supplies from the Bravo Dome CO_2 Unit in New Mexico, or from the McElmo Dome and Sheep Mountain CO_2 units in Colorado. Approximate percentage working interest shares in these three large source fields are as follows:

   a) *Bravo Dome*: Oxy, USA, Inc. ("OXY"), previously Amoco Production Company,

about 75%; Kinder-Morgan CO_2 Company, L.P., previously Shell, about 11%; Amerada Hess, about 10%; Exxon Mobil, previously Exxon, about 1.4%; and others, about 2.6%.

b) *McElmo Dome*: Kinder-Morgan, about 45%; and Exxon Mobil, about 44%, and others, about 11%.

c) *Sheep Mountain*: Exxon Mobil 50%; and BP-Amoco, previously Arco, 50%.

10. Approximate percentage ownership shares in the pipelines used to transport CO_2 from the three source fields to the EOR fields in the Permian Basin are as follows:

a) *Bravo Pipeline System (BPS)*: OXY, 81%; Kinder-Morgan, 13%; and XTO, previously Cross Timbers Oil Company, 6%.

b) *Cortez Pipeline Company (Cortez)*: Kinder-Morgan, 50%; Exxon *Mobil*, 37%; and Cortez-Vickers, 13%. Only Cortez-Vickers does not own an interest in the McElmo Dome CO_2 source field.

c) *Sheep Mountain Pipeline*: from the Sheep Mountain CO_2 source field to a point near the Bravo Dome CO_2 source field, where it interconnects with Rosebud Pipeline, Exxon Mobil, 50%; and BP-Amoco, 50%. From the Rosebud interconnection to the Denver City, Texas area, Exxon Mobil, 35%; BP-Amoco 35%; and Amerada Hess, 30%. Amerada Hess owns 100% of Rosebud Pipeline, which

transports CO_2 a short distance from the Bravo Dome source field to the Sheep Mountain Pipeline.

11. A very large percentage of the CO_2 produced by OXY, Kinder-Morgan, Amerada Hess, and Exxon Mobil at the Bravo Dome source field is used by each of them in their own respective EOR projects in the Permian Basin. Similarly, nearly all of the CO_2 produced at the Sheep Mountain source field has been used by Exxon Mobil and BP-Amoco at their EOR projects in the Permian Basin. Generally, at least 50%, and frequently much more than that, of the CO_2 produced by Kinder-Morgan at the McElmo Dome and Bravo Dome source fields has been used at its EOR projects in the Permian Basin.

Materials Examined

12. The sources that I have particularly reviewed and considered in connection with the preparation of this affidavit are the following:

    a) The April 1998 Class Action Settlement Agreement in *Feerer et al. v. Amoco Production Company* and Exhibit D-3 to that agreement entitled "Shell Qualified Contracts." Portions of the Settlement Agreement made September 24, 2001 in settlement of royalty litigation concerning the McElmo Dome Carbon Dioxide Unit. Concerning the latter agreement I focused on Sections 4 and 5 concerning

the requirements on Kinder-Morgan and Exxon Mobil in calculating future royalty and overriding royalty payments.

b) *Qualified contracts indexed to oil prices.*

- Contract 5, Meter No. 200A; CO_2 Sale and Purchase Contract between Shell Land and Energy Company and Shell Western E&P Inc., dated, December 1, 1994 (KMJCH 000021-47)
- Contract 6, Meter No. 200B; Wasson ODC Unit CO_2 Sale and Purchase Contract between Mabee Petroleum Corp. and Shell Western E&P Inc., dated May 1, 1993 (KMJCH 000048-76)
- Contract 12, Meter No. 221A; CO_2 Sale/Purchase Contract between Shell Western E&P Inc. and Shell Western E&P Inc., dated August 1, 1996 (KMJCH 000121-50)
- Contract 13, Meter No. 222; CO_2 Sale and Purchase Contract between Shell Onshore Ventures Inc. and Shell Western E&P Inc., dated July 1, 1996 (KMJCH 000151-80)
- Contract 15, Meter No. 204A; CO_2 Sale and Purchase Contract between Shell Western E&P, Inc. and Shell Western E&P Inc., dated August 1, 1996, and accompanying amendments (KMJCH 000181-000210)

- Contract 20, Meter No. 210D; CO_2 Sale and Purchase Contract between Shell Western E&P Inc. and Shell Western E&P Inc., dated August 1, 1996 (KMJCH 000211-50)

- Contract 23, Meter No. 215A; CO_2 Sale and Purchase Contract between Amoco Oil Company and Shell Western E&P Inc., dated March 1, 1997, and accompanying amendments (KMJCH 000251-88)

- Contract 42, Meter No. 223; CO_2 Sale and Purchase Contract between Seminole San Andres Unit and Shell Western Exploration and Production Inc., dated July 1, 1996, and accompanying amendments (KMJCH 000406-27)

- Contract 46, Meter No. 200C; CO_2 Sale and Purchase Contract between Arco Oil and Gas Company and Shell Western E&P Inc., dated October 1, 1993, and accompanying amendments (KMJCH 000428-88)

c) *Non-qualified contracts indexed to oil prices.*

- Contract 82, Meter No. 202E; Product Sale and Purchase Contract between Amerada Hess Corporation and Shell CO_2 Company, Ltd., dated October 1, 1998, and accompanying amendments (KMJCH 000573-601)

- Contract 235, Meter No. 280A; Product Sale and Purchase Contract between Altura Energy Ltd. and Shell CO_2 Company, Ltd., dated July 1, 1997, and accompanying amendments (KMJCH 000914-40)

- Contract 286, Meter No. 204B; CO_2 Purchase Contract between Kinder Morgan CO_2 Company, L.P. and Sonic Oil and Gas, L.P., dated August 1, 2002 (KMJCH 000491-93)

d) *Qualified contracts based on fixed prices.*

- Contract 7, Meter No. 210B; CO_2 Sale and Purchase Contract between Shell Frontier Oil and Gas Inc. and Shell Western E&P Inc., dated June 6, 1995 (KMJCH 000077-98)

- Contract 8, Meter No. 210C; CO_2 Sale and Purchase Contract between Shell Onshore Ventures Inc. and Shell Western E&P Inc., dated June 6, 1995 (KMJCH 000099-120)

- Contract 24, Meter No. 210A; CO_2 Sale and Purchase Contract between Bennett Ranch Unit Operator and Shell Western E&P Inc., dated June 6, 1995 (KMJCH 000289-312)

- Contract 31, Meter No. 212A; CO_2 Sale/Purchase Contract between Mobile Exploration and Producing U.S. Inc. and Shell Western E&P Inc.,

dated November 1, 1995 (KMJCH 000346-75)

- Contract 33, Meter No. 213A; CO_2 Sale/Purchase Contract between Transpetco Pipeline Company, L.P. and Shell Western E&P Inc., dated April 1, 1996 (KMJCH 000376-405)

e) *Non-qualified contracts based on fixed prices*

- Contract 233, Meter No, 211A; CO_2 Purchase Contract between Shell CO_2 Company Ltd. and Altura Energy Ltd., dated October 4, 1999 (KMJCH 000497-98)

- Contract 238, Meter Nos. 210G/211B; CO_2 Purchase and Sale Agreement between Altura Energy Ltd. and Shell CO_2 Company, Ltd., dated January 1, 2000 (KMJCH 000499-515)

- Contract 253, Meter No. 202F; CO_2 Purchase Contract between Kinder-Morgan CO_2 Company, L.P. and Amerada Hess Corporation, dated November 29, 2000 (KMJCH 000489-90)

- Contract 254, Meter Nos. 202H/211C; Product Sale and Purchase Contract between Marathon Oil (West Texas) L.P. and Kinder-Morgan CO_2 Company, Ltd., dated January 1, 2001 (KMJCH 000656-78)

- Contract 295, Meter Nos. 200G/201B; CO_2 Sale and Purchase Contract between Kinder Morgan CO_2 Company, L.P. and Occidental Petroleum Ltd., dated January 1, 2003, and accompanying amendments (KMJCH 000494-96)

- Contract 306, Meter No. 202G; CO_2 Sale and Purchase Contract between Kinder-Morgan CO_2 Company, L.P. and Amerada Hess Corporation, dated September 3, 2003 (KMJCH 000516-17)

f) *Contracts containing hidden consideration*

- Contract 28, Meter No. 260C; CO_2 Sale and Purchase Contract between Devon Energy Corporation (Nevada) and Shell Western E&P Inc., dated January 1, 1997 (KMJCH 000313-45)

- Contract 246, Meter Nos. 301A/601A; Product Sale and Purchase Contract between Occidental Permian Ltd. and Kinder-Morgan CO_2 Company, L.P., dated March 6, 2001, and accompanying amendments (KMJCH 000941-73)

- Contract 297, Meter Nos. 210H/200H/201C/201D; Product Sale and Purchase Contract between Occidental Permian Ltd. and Kinder

Morgan CO_2 Company, L.P., dated March 7, 2003 (KMJCH 000974-1 001)

g) Spreadsheets produced by Kinder-Morgan entitled "Post Settlement Bravo Dome Private Royalty Price Calculation By Delivery" for each month January 2000 through July 2004. I have reviewed and spot-checked some, but not all, of those reports to the extent that I understand what they purport to show. As a result of that review, I have arrived at certain observations regarding each Royalty Price Calculation sheet reviewed. In connection with this review I also examined Kinder-Morgan documents that reflect some data on CO_2 deliveries and pipeline volumes for the same month as the Royalty Price Calculation sheet. For example, the April 2004 Royalty Price Calculation is coupled with the delivery information for that month on documents 000700-000704.

h) Certain portions of my expert reports in *Powell v. Amoco Production Company* were revisited as a refresher of knowledge I have about the ownership and operation of CO_2 source fields Bravo Dome, McElmo Dome and Sheep Mountain, about the pipeline systems for transportation of the compressed CO_2 to EOR projects, and about the ownership and operation of EOR projects in the Permian Basin of West Texas and southeastern New Mexico.

i) A thirty-eight page, in color, illustrated presentation was printed from the Internet entitled "Kinder-Morgan CO_2 Tim Bradley," providing current information on Kinder-Morgan's CO_2 business generally; and specifically on its SACROC and Yates Field EOR projects.

j) The Affidavit of Dr. Stephen Becker dated September 15, 2004.

k) The Plaintiff's Class Action Complaint filed August 3, 2004 in this case.

Kinder-Morgan CO_2 Business

13. Kinder-Morgan is believed to be the largest producer at the combined Colorado and New Mexico CO_2 source fields. In calendar year 2004 Kinder-Morgan's CO_2 production amounted to approximately 13.2 billion cubic feet ("Bcf") at Bravo Dome and approximately 141.2 Bcf at McElmo Dome, for a total annual production of approximately 154.4 Bcf. That represented about 31.3% of total annual production in 2004 at the Bravo Dome, McElmo Dome, and Sheep Mountain CO_2 source fields.

14. Kinder-Morgan is the second largest user of CO_2 at the Permian Basin EOR projects. Kinder-Morgan's main EOR project is SACROC; it owns 97% of the field and is the operator. In calendar year 2004 Kinder-Morgan consumed approximately 124.2 Bcf at its EOR projects, and that amount represented nearly 26% of total annual CO_2 consumption

in 2004 at EOR projects in West Texas and New Mexico. Only OXY, at approximately 196 Bcf, consumed more CO_2 in 2004 for use in Permian Basin EOR projects.

Royalty Calculation Under The Settlement Agreement

15. As I previously stated, I am familiar with the Settlement Agreement in the Feerer case. A number of the provisions of the Settlement Agreement are especially relevant to issues in this litigation, and to the testimony of Kinder-Morgan's witness Stephen Becker. These include the following:

    - Par. 7.43 – Which defines "Unit CO_2" as gas produced from the Bravo Dome CO_2 Gas Unit, as saved and delivered into a pipeline or pipelines. The definition excludes gas from another CO_2 source, such as McElmo Dome.

    - Par. 9.3 – Which provides that Bravo Dome CO_2 royalty payments are to be based on the value of CO_2 at the "Unit Tailgate," i.e., compression, dehydration, and gathering costs shall not be deducted from the value or price of Unit CO_2 in calculating royalties.

    - Par. 11.2 (a) – Which provides that Kinder-Morgan and Hess are limited to taking an 11 cents/Mcf deduction in calculating their respective CO_2

royalty values for mainline transportation for all volumes transported and delivered from the Unit Tailgate to the Seminole San Andres Unit ("SSAU") or to the "Terminus Point" of the Bravo Pipeline System, near Denver City, Texas.

- Par. 11.3 – Which provides that any claim that Kinder-Morgan has used excessive transportation deductions or differentials, as described in Par. 11.1 and Par. 11.2, in deriving royalty settlement values shall be treated as a breach of the Settlement Agreement and not subject to mandatory arbitration, pursuant to Par. 16 of the Settlement Agreement.

- Par. 14 – This is the key provision that provides the weed specific royalty settlement methodology based on "benchmarks" to arrive at the Unit Tailgate prices to be used by Kinder-Morgan in calculating and paying royalties to Plaintiffs. Subparagraphs (a), (b) and (c) express the benchmarks that Kinder-Morgan "will utilize [in] the royalty settlement . . . " In summary they are: (a) "Unit CO_2" is the subject, (b) each individual lessee will use just their own weighted average price, (c) the prices or values will be established by Qualified Contracts (listed on Exhibit D-3) subject

to Qualified Transportation charges and the approved mainline deduction.

- Par. 14(e) identifies by exhibit the "Qualified Contracts" that are to be used in arriving at volume weighted average prices for royalty calculation purposes. 14(g) provides "Non-Qualified Contracts are "all contracts for the sale, exchange, or other disposition of CO_2 entered into by . . . Shell (Kinder-Morgan) after the date of this Agreement or not listed in Exhibit D-1, D-2 or D-3." In the case of Kinder-Morgan the Qualified Contracts are on Exhibit D-3. Thus, Non-Qualified Contracts are all contracts that are not identified as "Qualified Contracts" in the Settlement Agreement. 14(c) acknowledges that other benchmarks might be used in the future to determine royalty settlement values,

16. The parties agreed only to the use of known, existing and identified contracts for sale or disposition of CO_2 and specifically did not agree to the use of Non-Qualified Contracts in the agreed methodology for calculating settlement royalty values. Stated another way, the approved method in paragraph 14 (c) does not allow for the mixing of Non-Qualified Control prices with Qualified Contract prices. Accordingly, Kinder-Morgan on the one hand, and the Plaintiffs and members of the Class, expressly on the other, determined only to omit any "agreement

concerning whether or not such future benchmarks, and resulting future royalty payments, are or are not proper."

17. In Par.4 of Dr. Becker's Affidavit in this case, he states that the net-back calculation and the associated volume-weighted average price to be used in calculating settlement royalty values "is contemplated to result from a mix of both Qualified and Non-Qualified downstream contract prices." This conclusion is not correct. Par.14(c) of the Settlement Agreement provides that the parties to the Settlement Agreement agreed only to the use of "Qualified Contracts" in the methodology to be used in calculating royalty settlement values. In my experience, sales agreements in the petroleum industry do not "contemplate" how things are to be done; rather, they express what the parties intend to be done, i.e., they say what they mean. Had the parties intended to include Non-Qualified Contracts in the 14(c) benchmark, it would have been easy to write that into the Settlement Agreement.

18. Although Par.14(c) of the Settlement Agreement, recognizes that some other methodology using "other benchmarks that may be utilized in the future to determine royalty settlement values that are not qualified or approved herein," may at some time in the future be used, no other methodology or other benchmark royalty settlement values were agreed to by the parties to the Settlement Agreement. Furthermore, it is only

logical that the parties to the Settlement Agreement, and in particular, the Plaintiffs in that case, would never have agreed to having their royalty settlement values calculated by the Defendants in that case on the basis of unknown future methodologies and benchmarks using volumes and prices in unknown future CO_2 sales agreements.

19. In Par. 7 of his Affidavit Dr. Becker states that "For the period of January 2000 to July 2004, Kinder-Morgan arrived at a royalty settlement value for payment of royalty to participating Feerer class members utilizing the weighted average net-back methodology called for in the Settlement Agreement. This conclusion is wrong. It is wrong because Kinder-Morgan did not calculate royalty settlement values on the basis of the methodology specified in Par.14 (c) of the Settlement Agreement, which sets forth the only methodology agreed to by the parties to the Settlement Agreement. As previously discussed, Par.14 (c) of the Settlement Agreement requires that only Qualified Contracts may be used in deriving prices or values, but as Dr. Becker acknowledges, during the period January 2000-July 2004, Kinder-Morgan included volumes and prices under Non-Qualified contracts in its calculations of royalty settlement values contrary to the Settlement Agreement terms.

20. There is additional evidence that appears just from limited discovery of other instances where Kinder-Morgan has not calculated

royalty settlement values in accordance with the Settlement Agreement. These include:

a) As previously discussed, Kinder-Morgan is limited to taking a deduction for mainline transportation for deliveries to the Seminole San Andres Unit of $0.11 per Mcf. Nevertheless, I have determined in my review of Kinder-Morgan's royalty price calculations that in a number of months, mainline transportation deductions significantly greater than $0.11 per Mcf were taken. For example, Kinder-Morgan often deducts, in addition to the approved Bravo Pipeline System deduction of $0.11 per Mcf, a so-called "SWPL Metering Rate," which has ranged between $0.02 per Mcf and $0.09 per Mcf. Metering costs are part of pipeline transportation costs and, under the Settlement Agreement, all mainline transportation costs are to be recovered only at the approved $0.11 per Mcf mainline rate. In addition, from time-to-time Kinder-Morgan has deducted a so-called "Add'l PL Tariff Rate" of $0.025 per Mcf for deliveries to Amerada Hess at the Seminole San Andres Unit, in calculating its netback royalty settlement values. As previously stated, deliveries to SSAU are limited to a mainline transportation rate of $0.11 per Mcf under the Settlement Agreement.

b) The evidence suggests that Kinder-Morgan has failed to use correct values

under a number of contracts, including both Qualified Contracts and Non-Qualified Contracts, in calculating royalty settlement values. By way of example, these instances apply at a minimum to the following contracts:

- The January 1, 1997 Qualified Contract between Devon Energy Corporation (Buyer) and Shell Western E&P, Inc. (Seller), now Kinder-Morgan. Under this agreement, in addition to agreeing to a CO_2 sales price of $0.41 per Mcf, Devon conveyed to Shell a 50% working interest in the Midcross (Devonian) Unit, at a total sales price of $1.00. During the months of April and May of 2002, Kinder-Morgan included volumes and prices under the Devon contract at a sales price of $0.41 per Mcf, with no recognition being given to the significant additional value that is associated with its own, cost-free 50% interest in that commercial EOR project.

- The March 6, 2001, Non-Qualified Contract between OXY (Buyer) and Kinder-Morgan (Seller). Under this agreement, in addition to the stated fixed sales prices of $0.66 per Mcf for the first 51.5 Bcf of CO_2 sold, and $0.64 per Mcf for the remaining 123.5 Bcf of CO_2 sold, the parties entered into a related Gas Processing

Agreement, whereby Kinder-Morgan processes at its nearby SACROC facilities gas produced by OXY at its Cogdell Unit. Kinder-Morgan's calculations of royalty settlement values include significant volumes and values for this CO_2 sales contract, but they give no recognition to the related economic value of the gas processing agreement that was entered into with OXY at the time of the CO_2 sales agreement was made.

- The August 1, 1996 Qualified Contract between Shell Western E&P (Buyer) and Shell Western E&P (Seller), both now being Kinder-Morgan. This agreement calls for a minimum contract price of $0.625 per Mcf, but for higher prices in the event West Texas Sour Crude Oil prices rise above $18.00 per barrel. During many months after January, 2001, Kinder-Morgan included volumes and values for this contract in its calculations of royalty settlement values, but at prices below $0.625 per Mcf, (e.g. 57¢) notwithstanding the fact that West Texas Crude prices had risen to levels well in excess of $18.00 per barrel. Then, beginning in April 2004, the price used by Kinder-Morgan for this contract in calculating royalty settlement values suddenly moved from $0.58 the previous month to $1.039 per

Mcf in April 2004 and to $1.15 per Mcf in July 2004, and remained at or above that higher level through July 2004. Based on my review of West Texas crude oil prices during the period January 2001 through July 2004, the correct contract prices for royalty settlement purposes should have been far greater than the contract prices that were used by Kinder-Morgan during most of that 43-month period.

21. My analysis of the Defendant's CO_2 pricing and royalty payment practices for this case is ongoing. The opinions and conclusions contained in this Affidavit are based, in part, on the limited discovery materials that have been produced to date by Kinder-Morgan. Therefore, I expect to develop additional opinions and conclusions as I continue my analysis and as more discovery materials are produced in this case.

/s/ George L. Donkin
George L. Donkin

SUBSCRIBED AND SWORN TO BEFORE ME this 18th day of February 2005.

/s/ [Illegible]
Notary Public, State of Virginia

My Commission Expires: November 30, 2007

George L. Donkin

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EDUCATION

M.A., Economics, University of Maryland, 1973.
B.A., Economics, University of Maryland, 1970.

Mr. Donkin is a Vice President of J.W. Wilson & Associates, Inc., a consulting firm specializing in utility regulation, the economics of the natural gas industry, telecommunications studies, and antitrust economics. He is a nationally-recognized expert on energy and regulatory economics who has presented expert testimony on many occasions before federal and state courts, public utility regulatory bodies, arbitration panels and congressional committees.

Mr. Donkin's consulting work since 1974 has focused specifically on the following subjects:

- Natural gas and petroleum demand analysis.
- Energy supply contract negotiations.
- Petroleum and natural gas price forecasts.

- Crude oil and natural gas market value studies.
- Regulated utility revenue requirements and rate design.
- Energy supply procurement strategies.
- Property tax appraisals.
- Restructuring issues in the natural gas and electric utility industries.
- Competition and antitrust analysis.

A list of Mr. Donkin's publications and expert testimony is presented in Attachment.

[Attachment A Omitted In Printing.]

STATE OF NEW MEXICO
COUNTY OF UNION
EIGHTH JUDICIAL DISTRICT

J. CASPER HEIMANN, PECOS SLOPE ROYALTY TRUST and RIO PETRO LTD., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit New Mexico similarly situated.

Plaintiffs,

vs.

KINDER-MORGAN CO2 COMPANY, L.P.,

Defendant

No. D-818-CV-2004-00026

AFFIDAVIT OF DR. STEPHEN BECKER

STATE OF TEXAS)
) ss.
COUNTY OF Travis)

Stephen L. Becker; Ph.D., being first duly sworn on oath, deposes and says:

1. I am a founding Partner and Director of Applied Economics Consulting Group, Inc. ("Applied Economics") in Austin, Texas. Applied Economics conducts economic and financial analysis for a wide variety of clients across a number of industries. I

have an undergraduate degree in Computer Science and Engineering from the Moore School of Electrical Engineering at the University of Pennsylvania, a Master of Business Administration degree with a concentration in Finance from the University of Texas at Austin, and a doctorate in Public Policy from the LBJ School of Public Affairs at the University of Texas at Austin.

2. I have significant experience with corporate financial analysis, economical analysis, and economic and financial modeling. I have extensive experience in the oil and gas industry over the last 23 years. I have been engaged as an expert in various matters involving carbon dioxide. In the course of these matters I have performed extensive research and analysis of issues surrounding production, transportation and marketing of CO2. I have conducted studies and investigations of the Bravo Dome CO_2 Unit located in the State of New Mexico in regard to the Doris Feerer, et al vs. Amoco, et al litigation, the Powell vs. Amoco, et al litigation and various non-litigation assignments. I have also conducted studies and investigations concerning the McElmo Dome (Leadville) Unit in regard to several litigation matters. I am currently serving as the defendants' designated expert for the administration of the CO2 Claims Coalition settlement at the McElmo Dome field in Colorado. In that capacity I provide an annual review of all contracts of the sale of CO2 from the McElmo Dome field and an analysis of whether those contracts reflect "market value" per the terms of that settlement agreement. As such, I have relevant experience in and an understanding of the issues present in this matter and both my

academic and professional experiences qualify me to present this affidavit.

3. I have reviewed the Settlement Agreement from the Feerer matter, a copy of which is attached as Exhibit 1 to the Motion to Compel Arbitration (the "Motion"), and in particular have studied the provisions relating to the terms under which the Feerer defendants (and therefore Kinder Morgan as successor-in-interest to Shell) are to compute and pay royalty to class members.

4. The Settlement Agreements sets forth in detail the process by which Kinder Morgan should be paying royalties to the Feerer settlement class members. In summary, this process contemplates that Kinder Morgan will pay its owners on an entitlements basis using a volume weighted average of its respective prices for Unit CO2 utilizing a net-back from downstream sales or other dispositions. The Settlement Agreement specifically identifies certain sales and/or disposition contracts as "Qualified Contracts". Similarly, the Settlement Agreement identifies and defines "Approved Mainline Deductions" and "Qualified Other Transportation Charges". The Settlement Agreement further defines "Non-Qualified Contracts" and "Non-Qualified Other Transportation Charges". As such, the net-back calculation – and the resulting volume-weighted average price – is contemplated to result from a mix of both Qualified and Non-Qualified downstream contract prices that are then reduced by a mix of both Qualified and Non-Qualified Other Transportation Charges and the Approved Mainline Deduction.

5. Settlement Agreement §16 further stipulates that any claims against Shell (and hence Kinder Morgan) regarding the price of value under Non-Qualified Contracts (or under amendments to or extensions of Qualified contracts) that are utilized in establishing royalty settlement values shall be submitted to binding arbitration. Similarly, Settlement Agreement §16 stipulates claims regarding Non-Qualified Other Transportation Charges (or under amendments to or extensions of Qualified Other Transportation Charges) that are utilized in establishing royalty settlement values shall be submitted to binding arbitration.

6. I have reviewed and analyzed the process by which Kinder Morgan determined and paid royalty on CO2 from the Bravo Dome Unit to Plaintiffs and the putative class in this matter since January 2000. My analysis included the following steps:

   a. Review and analysis of the royalty calculation worksheets used to establish the royalty settlement price for parties to the Settlement Agreement for each month from January 2000 through July 2004 (attached to the Motion as Exhibits 2-6);

   b. Review of all sales contracts used as the basis for royalty settlement calculations described in step(a) (a summary of which is attached to the Motion as Exhibit 7); and

   c. Review of a sample of remittance statements for J. Casper Heimann and the other named plaintiffs in the Bravo Dome Unit covering

the January 2000 to July 2004 time period (attached the Motion as Exhibit 8).

7. Based on my review and analysis, I have determined the following:

   a. For the period January 2000 to July 2004, Kinder Morgan arrived at a royalty settlement value for payment of royalty to participating Feerer class members utilizing the weighted average net-back methodology called for in the Settlement Agreement. Specifically, Kinder Morgan determined the royalty settlement values for class members using a volume weighted average net-back calculation involving five components:

      i. Downstream prices and values for CO2 under Qualified Contracts;

      ii. downstream prices and values for CO2 under Non-Qualified Contracts (including amendments to or extensions of Qualified Contracts); plus

      iii. deductions from downstream prices and values for Qualified Other Transportation charges;

      iv. deductions from downstream prices and values for Non-Qualified Other Transportation Charges (including amendments to or extension of Qualified Other Transportation Charge); and

      v. deduction of the Approved Mainline Deduction of $0.11 per mcf.

b. Individual class member royalty payments were based on the per-mcf settlement price determined per this process each month times each class member's respective entitlement volume for the month.

8. I have reviewed the complaint in the above-referenced matter. Based on my review of the complaint, the relevant economic claim of the plaintiffs is an allegation that Kinder Morgan has underpaid royalties to the class since January 1, 2000. Based on the analysis described above, I have determined that class members' royalty values were based exclusively on Qualified Contracts. Non-Qualified Contracts, Qualified Other Transportation Charges, Non-Qualified Other Transportation Charges and the Approved Mainline Deduction. My understanding is that Qualified Contracts, Qualified Other Transportation Charges, and the Approved Mainline Deduction were approved by the class and hence, are not subject to challenge. Therefore, any challenge to the values paid is, from an economic standpoint, necessarily a challenge to Non-Qualified Contracts or Non-Qualified Other Transportation Charges.

Dated this 15th day of September, 2004.

/s/ Stephen Becker, Ph.D.
Stephen Becker, Ph.D.

Subscribed and sworn to
before me this 15th day of
September, 2004.

/s/ Leona Johnson
Notary Public, Travis County,
State of Texas

My Commission Expires
7/22/2006

[SEAL]	LEONA JOHNSON Notary Public State of Texas My Commission Expires July 22, 2006

STATE OF NEW MEXICO
COUNTY OF UNION
EIGHTH JUDICIAL DISTRICT

J. CASPER HEIMANN, PECOS SLOPE ROYALTY TRUST and RIO PETRO LTD., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico similarly situated,	)	No. 04-26 CV
Plaintiffs,	)	
VS.	)	
KINDER-MORGAN CO2 COMPANY, L.P.,	)	
Defendant.	)	

* *

ORAL DEPOSITION OF
STEPHEN L. BECKER, Ph.D.
February 18, 2005

* *

ORAL DEPOSITION OF STEPHEN L. BECKER, Ph.D., produced as a witness at the instance of the Plaintiffs, and duly sworn, was taken in the above-styled and numbered cause on the 18th day of February, 2005 from 11:00 a.m. to 2:04 p.m., before Marlene Erives, CSR in and for the State of Texas, reported by machine transcription, at the Law Offices

of Vinson & Elkins, 2801 Via Fortuna, Suite 100, Austin, Texas, pursuant to Rules 1-026 and 1-030 of [2] the New Mexico Rules of Civil Procedure for District Courts and the provisions stated on the record and attached hereto.

* * *

[66] price on which the royalty's paid?

A. From the face of the check stub, I would say there's – there's nothing in here that would – you can't tell from the check stub which contracts, be that it's qualified or non-qualified – I mean, looking at this you wouldn't know when qualified contract number 3 was discontinued and was no longer being used.

Q. Or you wouldn't know that only qualified contracts were being used to arrive at the price?

A. That's correct. I, mean the check stub is not at that level of detail. And I don't see anything, and maybe there's a section you can point me to if I just missed it in my review of this, where the parties set forth a desire to have that level of detail.

Q. Well, do you know anything that's been done by Kinder-Morgan to inform the other parties to this agreement, that is, the royalty owners, that other benchmarks are to be used, and the other benchmark is to [67] include non-qualified contracts?

A. No. I don't know one way or the other.

Q. Well, Kinder-Morgan has provided you no information to the effect that they have disclosed that

to the royalty owners since the settlement agreement was made; is that a fact?

A. That's a fact.

Q. Did you compile any kind of a list that indicates the nature of the contracts, qualified or non-qualified, that were used in these – Exhibit 4, example, royalty calculation spreadsheets?

* * *

[77] is attributed to that delivery. So, yes, it would be a benchmark different from the price, the price or value you'd see under qualified contracts.

Q. So the other benchmark, then, can come into use unilaterally; that is to say, simply by Kinder-Morgan deciding it's going to use some non-qualified contracts, [78] it can initiate another benchmark for calculation of the royalty?

A. Yeah. I mean, I wouldn't characterize it as "initiate another benchmark" because in my mind it leaves a reader with the impression that you've done this whole sale change from when we were doing it this way, and we unilaterally decided to pick up and go value it on this other thing. The use of prices and values obtained under non-qualified contracts is a benchmark different from those that you get from qualified contracts. And I would agree that per the terms of the settlement agreement, I don't see anything that says that Kinder-Morgan has to get permission from anyone to begin using non-qualified contracts, nor do I see anything in here that requires

that Kinder-Morgan provide any notice that it's doing so. The settlement agreement anticipates that it's going to be done in my reading of it. But I don't see any approval step called for here.

Q. So the settlement agreement in speaking to other benchmarks contemplates or anticipates that one of these parties to the agreement without participation by the other parties to the agreement can adopt another or a different benchmark?

A. They can't adopt a new methodology, but they can – the components of the ultimate price that is paid [79] can include other benchmarks other than qualified contracts without notice to the other party.

Q. Right. In other words, unilaterally that can be done?

A. Yes.

Q. Do you know whether after this agreement was made in 1998 and in 1999, whether Shell used only approved or qualified, I should use the word "qualified," contracts in order to calculate and pay the royalty?

A. I don't know one way or the other. I haven't done any review of their royalty payments.

MR. GALLEGOS: I think that's all my questions.

MR. LIPE: We'll reserve ours.

(Deposition concluded at 2:04 p.m.)

STATE OF NEW MEXICO
COUNTY OF UNION
EIGHTH JUDICIAL DISTRICT

RUSSELL GARY HEIMANN, PECOS SLOPE ROYALTY TRUST and RIO PETRO LTD., individually and on behalf of all other private royalty and overriding royalty owners in the Bravo Dome Carbon Dioxide Unit, New Mexico similarly situated,

Plaintiffs,

vs.

KINDER-MORGAN CO2 COMPANY, L.P.,

Defendant.

No. 04-26 CV

(Filed Aug. 9, 2007)

CLASS CERTIFICATION ORDER

THIS MATTER came before the Court on July 30, 2007 for consideration of the Plaintiffs' Motion for Class Certification filed September 17, 2004. The Court ordered additional briefing which has been completed. Plaintiffs' Supplemental Brief served February 22, 2005, narrowed the claims sought to be certified by plaintiffs to breach of contract, breach of the implied covenant of good faith and breach of the implied covenant to market. The Court has reviewed the extensive memoranda, affidavits and documents submitted by the parties and the relevant authorities.

The Court FINDS and CONCLUDES that the plaintiffs have met the requirements of Rule 1-023(A) and (B)(3) NMRA for class certification on the contract claims set forth in the Complaint with respect to breaches of the Feerer Settlement Agreement as follows:

1. After the initiation of this action, the plaintiff J. Casper Heimann died. In his place as a plaintiff is his son Russell Gary Heimann. The other plaintiffs are Pecos Slope Royalty Trust and Rio Petro Ltd. All plaintiffs are owners of royalty and overriding royalty burdening leases held by defendant Kinder-Morgan CO2 Company, L.P. ("Kinder-Morgan") in the Bravo Dome Carbon Dioxide Unit ("Unit") located in Union, Harding and Quay Counties, New Mexico.

2. Plaintiffs have brought a class action on behalf of the Unit royalty and override interest owners to recover damages allegedly resulting from Kinder-Morgan improperly calculating and paying royalties on carbon dioxide ("CO2") produced from the Unit by it.

3. Plaintiffs are parties to, or successors or assigns of parties to, the Class Action Settlement Agreement in the federal court proceeding styled *Doris Feerer, et al. v. Amoco Production Company* in United States District Court of the District of New Mexico, Civ. No. 95-0012 JC/WWD ("Feerer Class Action"). The *Feerer* class action Settlement Agreement included Shell CO2 Company Ltd., Kinder

Morgan's predecessor-in-interest, and other Unit working interest owners.

4. Plaintiffs allege that they and all class members have been damaged because Kinder-Morgan has allegedly failed to calculate and pay the royalty and overriding royalty on the proper value of the produced CO2 in accordance with the *Feerer* Settlement Agreement. Plaintiffs claim that Kinder-Morgan's actions breach the *Feerer* Settlement Agreement. Kinder-Morgan denies each of these allegations.

5. The class consists of approximately 600 members. It is so numerous that joinder of all members is clearly impractical.

6. The rights and obligations of plaintiffs, class members and the defendant are based on the *Feerer* Settlement Agreement. The issues concerning alleged breaches of the *Feerer* Settlement Agreement and alleged attendant implied covenants and duties arising under the *Feerer* Settlement Agreement present common issues of fact and law.

7. Kinder-Morgan has calculated and paid royalties and overrides to all its royalty and overriding royalty owners in the Unit on the same basis each month according to each royalty and override owner's respective fractional ownership interests in the Unit. The claims of the named plaintiffs are based on the same alleged improper prices and are typical of the claims of the class members.

8. The plaintiff Russell Gary Heimann and the plaintiff entities, by trustees and partners, Robert P. Creson and Cynthia Clendenen, are prepared to prosecute the case on behalf of the class. Their interests are compatible with the class and they have employed experienced and expert legal counsel who have specialized in oil and gas law, in complex litigation and handled numerous class actions.

9. The plaintiffs have narrowed the claims for which they seek certification to only their contract-based claims for alleged breach of the *Feerer* Settlement Agreement and alleged breach of alleged implied obligations and duties arising under the *Feerer* Settlement Agreement. The issues inherent in those claims are subject to generalized proof and would require no individual proof as to liability.

10. A class action is the only practical way to adjudicate the claims of the royalty/override owners against Kinder-Morgan. For a large number of the class the costs to individually litigate their claims would exceed any potential recovery they might have.

11. This is a New Mexico case even though some class members reside in other jurisdictions. Because of the aggregation of significant contacts creating New Mexico interest in this matter the law of this forum should control and application of the forum law to the class issues will not violate constitutional principles of due process.

12. The numerosity, commonality and typically requirements of Rule 23(A)(1), (2 and (3) NMRA are

satisfied with regard to claims for which Plaintiffs seek certification as described in paragraph 9 above.

13. The requirements of Rule 23(A)(4) NMRA are satisfied with regard to the claims for which Plaintiffs seek certification as described in paragraph 9 above where here the class plaintiffs are represented by qualified attorneys and the plaintiffs have a strong interest in proving the allegations concerning Kinder-Morgan's conduct and protecting the interests of the class.

14. The requirements of Rule 23(B)(3) NMRA are satisfied with regard to the claims for which Plaintiffs seek certification as described in paragraph 9 above because questions of law or fact raised by such claims are common to the members of the class and predominate over any questions affecting individual members.

15. The defendant Kinder-Morgan does not oppose the grant of plaintiffs' motion for class certification with regard to claims for alleged breach of the *Feerer* Settlement Agreement and alleged breach of alleged implied obligations and duties arising under the *Feerer* Settlement Agreement.

IT IS THEREFORE ORDERED as follows:

1. The Court has jurisdiction of the subject matter and jurisdiction and venue in Union County is proper.

2. The plaintiffs' motion for class certification should be and is GRANTED only with regard to the claims described below.

3. The Court certifies this action as a class action under Rule 1-023(B)(3) NMRA only with regard to claims for alleged breach of the *Feerer* Settlement Agreement and for alleged breach of alleged implied obligations and duties arising under the Feerer Settlement Agreement, and to that extent, this action shall be maintained and proceed as a class action on behalf of the following class:

> All present and former owners of royalty interests since January 2000 that burden leases, or of overriding royalty interests that burden working interests, held by defendant Kinder-Morgan CO2 Company, L.P. (its predecessors and successors) in the Bravo Dome Unit who were settling plaintiffs or settling class members under the Class Action Settlement Agreement in Feerer, et al. v. Amoco Production Company, et al. USDC, Dist. NM, CIV 95-0012 JC/WWD, or are successors, heirs or assigns of such settling plaintiffs or settling class members; excluding the defendant and all of its corporate parents, subsidiaries or affiliates.

4. The causes of action that are certified for class treatment are limited to claims for : (a) breach of the Feerer Settlement Agreement; (b) breach of the alleged duty of good faith and fair dealing under the *Feerer* Settlement Agreement; and (c) breach of the

alleged implied covenant to market under the *Feerer* Settlement Agreement.

5. Russell Heimann, Pecos Slope Royalty Trust, and Rio Petro Ltd. are designated as the class representatives, and the law firms of Gallegos Law Firm, P.C. and the Alsup Law Office are designated as counsel for the class.

6. Except as expressly provided herein to the contrary, plaintiffs' motion for class certification is denied.

DATED July 30, 2007.

/s/ Eugenio S. Mathis
Honorable Eugenio S. Mathis
District Court Judge

SUBMITTED BY:

GALLEGOS LAW FIRM, P.C.

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